Determinants of the demand for microenterprise finance in urban Egypt

Nasr, Mohamed Saad El-din

Determinants of the Demand for Microenterprise Finance in Urban Egypt

By

Mohamed Saad El-din Nasr

A thesis submitted to the Faculty of Social Sciences in candidacy for the degree of Doctor of Philosophy

IMEIS

University of Durham

2002

To my parents, late grandmother and my sister

Abstract

Understanding how urban microenterprises perceive and respond to the different types of finance is a prerequisite to determining their prospects for growth, which is necessary for the appropriate design of policy and financial institutions. Large amounts of resources are being channelled to the microenterprise sector, especially through the non-governmental organisations (NGOs). The general attitude among many of the researchers and policy makers is that the demand for finance is unlimited. This study shows, however, that this assumption is debatable. It questions whether finance gaps actually exist, and if they do, whether they are of any significance for the development of urban microenterprises.

In addition to examining the finance gap, the financial source preferences and needs of the urban microenterprise sector in Egypt are also examined. This study seeks to provide an insight into a dimension of urban microenterprise research for which there is limited data. Virtually, no research to date has examined whether different forms of finance formal and informal actually help the microenterprise business. A detailed empirical study of how microenterprise owners finance their enterprises was carried through the use of a structured questionnaire conducted on 95 urban microenterprises, with the adoption of a quasi-experimental approach.

The results reported in this thesis indicate that using finance as a form of assistance will not much help this sector; both formal and informal borrowers have not experienced any significant difference in their growth pattern. Cultural, social backgrounds and microenterprise personal characteristics do have a role in shaping microenterprise financing decision. Also this study has shown that this sector is bankable and that there are a lot of lessons to be learned from this study by researchers, policy makers and financial institutions. The work revealed that the creation of conditions that would support self-sufficiency appears to be more important than the availability of formal financing.

Contents

List of Figures

List of Tables

Acknowledgements

First and foremost I am grateful to Allah (S.W.T) for his blessings. Through His will and His help I have been able to complete this thesis.

I dedicate this dissertation to my parents, late grandmother and my sister. They were very instrumental in encouraging me to strive towards my goals with a sense of responsibility and integrity. For that, and countless other things they did for me, I am grateful.

In expressing my appreciation for those who helped me make this dissertation a reality, I thank the faculty and staff of the IMEIS. The sensitive, caring nature and helpful attitude of the staff made me feel fortunate to be associated with such professionals. I am most grateful to Prof. Rodney Wilson, who without his advice I would have never completed this dissertation, His exuberance was contagious. Finally, I thank all of my friends.

To all of the above I say thank you very much.

Author's Declaration

I confirm that the material contained in this thesis has not previously been submitted for a degree in this or any other university, and the work has not been based on joint research.

Mohamed Saad El-din Nasr

Statement of Copyright

Abbreviations

$US	United States' Dollars
ABA	Alexandria Business Association
CAPMAS	Central Agency for Public Mobilisation and Statistics
CARE	Cooperative for American Remittances to Europe
CEOSS	Coptic Evangelical Organisation for Social Services
CGAP	Consultative Group to Assist the Poorest
CGC	Credit Guarantee Corporation
CIDA	Canadian International Development Agency
CSE	Credit for Self-Employment and Small Enterprise programme
DANIDA	Danish International Development Agency
ERSAP	Economic Reform and Structural Adjustments Program
ESEDA	Egyptian Small Enterprises Development Association
GDP	Gross Domestic Product
IFC	International Finance Corporation
ILO	International Labour Office
LE	Liver Egyptian (Egyptian pound)
M-W	Mann-Whitney
MFIs	MicroFinance Institutions
MIC	Ministry of International Cooperation
MoSA	Ministry of Social Affairs
MSEs	Micro and Small Enterprises
NBD	National Bank for Development
NGOs	Non-Governmental Organisations

PBDAC	Principal Bank for Development and Agricultural Credit
POH	Pecking Order Hypothesis
RDIs	Rural Development Institutions
REMM	Resourceful, Evaluative, Maximising Model
ROI	Return On Investment
RoSCAs	Rotating Savings and Credit Associations
SFD	Social Fund for Development
SME	Small and Medium Enterprises
SMEP	Small and Micro Enterprise Project
SPSS	Statistical Package for the Social Sciences
SSE	Small Scale Enterprise
UNDP	United Nation Development Programme
USAID	United States Agency for International Development

Exchange Rate

The field work for this study was carried out in Cairo, Egypt in early 2001. At that time the exchange rate was approximately one British pound = 6.15 Egyptian pounds and one US dollars = 4.35 Egyptian pounds.

Chapter One: Introduction

1.1 Research background

Interest in the role of urban micro and small enterprises (MSEs) in the development process continues to be in the forefront of policy debates in developing countries mainly due to the emergence of the educated unemployed, the increase in unemployment in urban areas, and the structural imbalance between rural and urban areas. Despite the fact that MSEs' role in economic development is controversial, and that they play a declining role as countries develop, MSEs have been given prominence in many development plans as well as in the strategies of many donor countries due to their alleged role in the creation of jobs and the alleviation of poverty (Liedholm and Mead 1999).

MSEs are considered to be a major feature of the economic landscape in all developing countries today. The advantages claimed for MSEs are various. MSEs may utilise labour intensive technologies, which could have an immediate impact on employment generation. Also, they can usually be established rapidly and put into operation to produce quick returns. They, also, may well become a countervailing force against the economic power of larger enterprises. More generally, the development of MSEs is seen as accelerating the achievement of wider economic and socio-economic objectives, including poverty alleviation (Lapar 1991; Cook and Nixson 2000). Thus, development theories have shifted focus from the medium and large scale enterprises, which can absorb large amounts of growth capital and be amenable to technological adaptation from industrialised countries, to the micro and small enterprises, which can satisfy basic human needs and growth in terms of employment and income generation.

The microenterprise sector plays a significant role in most of the developing countries. For example in most Latin American countries, according to a World Bank report in Dhumale et al. (1999), during the mid 1990's the microenterprise sector employed more than 50 percent of the labour force. Between 1990 and 1995 an average of 84 out of 100 new jobs in the region were generated by microenterprises. Although the Gross Domestic Product (GDP) contribution of this sector is harder to estimate due to its scale and widespread informality, the measures of microenterprises' participation in the GDP range from less than 10 to 50 percent, depending on the country and method of estimation. In Egypt, recent statistics show that microenterprises play a significant role in the economic and social development of Egypt. Egypt's microenterprises numerically dominate the private sector with 92.6 percent of the private economic non-agriculture enterprises employing less than five workers, according to the latest census undertaken by the Central Agency for Public Mobilisation and Statistics (CAPMAS) in 1996. This CAPMAS census includes the formal and informal sector excluding people such as consultants, architects, or computer programmers who may have low incomes but still have high human capital (Ministry of Economy 1998). As mentioned by Liedholm and Mead (1999) the number of such enterprises is far larger than what is reported in most official statistics, as they often cover only enterprises that are registered, or in other words recognised by the authorities. It is clear that the large numbers of the smallest enterprises escape the attention of the administration either because they seek to remain hidden, or because the officials do not have the staff to pursue those that do not register.

In Egypt, the 1980s and the early nineties have witnessed an increasing inability of the large, the medium enterprises, and the state bureaucracies to create enough jobs. This was especially visible in urban areas, which has been caused by a range of factors, such as rural-urban migration and the structural adjustment policies. Given these contexts, MSEs in both formal and informal economic sectors are now being proposed as a new alternative for achieving sustainable socio-economic development.

The development community, governments, donors, and researchers came to view microenterprise finance as an important tool for poverty alleviation and economic empowerment. Therefore, efforts to expand access to financial services for microenterprises have been associated with the strategy to enhance the economic activity of low-income or poor people (Dichter 1999). It is worth mentioning that contrary to the common view that microenterprise owners are poor and in need of assistance, the microenterprise sector is not homogeneous and poverty-stricken, but rather a highly heterogonous collection of enterprises ranging from units engaged in survival activities to highly sophisticated businesses as shown in figure 1.1. Therefore, microenterprise finance should not be equated with poverty reduction, as commonly assumed, without empirical validation. There is no clear empirical evidence for such an argument, thus making it difficult to justify MSEs promotion on the basis of inherent economic benefits of smallness and poverty alleviation. Recent studies demonstrate that not all microenterprise owners are poor; therefore, the attempts made to draw a causal link between microenterprises and poverty alleviation so as to justify policies and subsidies in favour of microenterprises is not empirically justified. Searching for further justification to promote smallness as an instrument of poverty alleviation is not necessary. The real reason that developing countries governments should be interested in microenterprises is because they account for a large share of enterprises and employment (Sethuraman 1981; Hulme and Mosley 1996a; Gulli 1998; Liedholm and Mead 1999; Zaman 1999). Nevertheless, this sector includes groups that are particularly vulnerable to poverty in significant numbers as will be discussed in section 1.3.1. The percentage of poor microenterprise owners varies by country, and is highest in the poorest countries.

Based on the above argument and for the purpose of this study, microenterprise finance will not be equated with poverty alleviation but will be viewed as the very small businesses unit that could not offer collateral or be accepted by the mainstream formal credit market. Most of the microenterprises have insufficient collateral to secure a bank loan. The formal financial institutions thus neglect this market segment and microenterprises are allegedly left with limited alternatives, as traditionally asset-based lending regards the microenterprise as unbankable and uncreditworthy. Therefore, this study views microenterprises as a neglected segment of the financial market and excluded from credit and other services by commercial banks.

1.2 Motives and contributions of the study

The interest in microenterprise finance in general, and in Egypt in particular, was motivated, firstly, by the proliferating literature during the late 1980's and early 1990's, and the growing interest amongst international organisations, especially the World Bank and the regional development banks. The past two decades have seen the emergence of powerful new methodologies for delivering microfinance services, especially microcredit. Much of this innovation has been pioneered by Non-Governmental Organisations (NGOs), mainly microenterprise programmes (Christen and Rosenberg 2000). However in Egypt the literature available on microenterprise finance is limited, as foreign funded microenterprise programmes have not been on the ground for that long. Microenterprise finance remains a fairly new sector in the Middle East and North Africa; most microfinance programs in the region, about 70 percent, were launched in 1987-97, and less than 10 percent existed before 1985. Furthermore, despite the multiplicity of donor agencies funding microcredit programmes (e.g. USAID, SFD, CIDA, and CARE), the material available is somewhat limited except for a few internal evaluations prepared by donor agencies and NGOs. Many of these evaluations were commissioned by the donor agencies funding these projects; hence, the objectivity and credibility of some of their results need to be scrutinised (Brandsma and Chaouali 1998). Therefore there is a need for such a research that would enhance the knowledge of the microenterprise demand for finance in Egypt.

Secondly, a number of studies have explored the possibility of finance gaps and many have highlighted the particular difficulties inherent in the supply of finance to microenterprises. However, very little research has examined microenterprises' real demand for finance (Howorth 1999). Most surveys have sought to capture the range of factors that inhibit the growth and development of microenterprise. A large proportion of this information has been collected through questionnaires asking microenterprise owners and managers to give their views on the kind of constraints they face, whether it is related to such factors as access to finance, poor managerial skills and lack of training opportunities or the high cost of inputs. Few studies have concentrated on a particular constraint so that finance has most often been identified as an inhibiting factor as part of a larger investigation of a wider range of variables.

Therefore, the results in terms of the significance of finance acting as a constraint to development are mixed, and it is difficult to draw rigid conclusions about (Howorth 1999; Cook and Nixson 2000). Furthermore, these studies do not have an analytical framework within which issues of financial constraints are well integrated and analysed. The vast majority of studies are used to generate basic information and have not clearly sought to test hypotheses (Cook and Nixson 2000). Therefore, there is a strong need for research that goes beyond the descriptive and much deeper into the analysis.

Thirdly, previous studies on access to credit[1] by microenterprise in Egypt do not provide an in-depth understanding of the dynamics and factors that determine microenterprise access to financial resources. There was a host of possible influencing factors suggested by the rather broader small enterprise literature such as structural barriers in both formal and informal markets, which inhibit the ability of banks in Egypt to satisfy demand for financial services among low-income markets. They have focused mostly on the supply of credit from the formal institutional sources and the policies which regulate the provision of credit by formal lending institutions. Microenterprise finance in Egypt still lacks significant studies of the importance of the cultural influence on the overall decision-making and financing processes. This stimulated us to explore what relations, norms, actions and processes influence, directly or indirectly, the transactions of borrowers.

Fourthly, the majority of formal microenterprise finance projects are top-down approaches, paternalistic thinking, where governments and donor agencies have imposed projects on people without addressing or having representation of the real demands or the interests and aspirations of the borrowing groups they have targeted. It is no surprise that they fail as they neglect the entrepreneurial experience and the knowledge of the local conditions and the importance of the cultural influence on the overall decision making and financing process. As mentioned by Dale W. Adams and J. D. Von-Pischke in Bouman and Hospes (1994), these microenterprise credit programs resemble earlier attempts to assist operators of small farms: both programs involve similar assumptions, both contain similar policies, both struggle with similar

[1] The words *credit* and *finance* are used interchangeably in this thesis.

definitional issues, both use the same type of project justification, and, as a result, both are likely to encounter similar problems. They added that in both cases the targeted groups were viewed as being too poor to adopt new technologies without formal loans and also as being too poor to save. Furthermore, as mentioned by Cohen (2001) the institutionalisation of listening to clients appears to have disappeared from the view of many microenterprise credit programmes. Financial institutions can significantly improve their effectiveness by being more responsive to the microenterprise's own perspective about the finance demand; i.e. through an upward flow of information and not a top down approach. Therefore, this study attempts to correct some of these misconceptions through the empirical research on the microenterprises' perceived demand for finance.

Finally, not much is known about the informal finance in urban areas. The presumption that the urban sector is adequately serviced by formal financial institutions could be the reason why little attention has been given to the informal finance (Lamberte 1992). Therefore, it is important to understand the character of the informal finance that is supporting the urban microenterprise sector. Furthermore, there is no detailed examination conducted into the contribution made by the different forms of finance, mainly the informal finance sector, within the Egyptian context. Most of these studies were undertaken in the Indian subcontinent, especially Bangladesh and India, in South America and to a lesser extent in the Far East. All of these countries have different cultures. This lack of sufficient research into the informal finance market in the developing countries has been hampered by a number of prejudices and stereotyped characterisations of lenders. These have helped to sustain a belief in the moral and technical superiority of the formal finance sector. Hence, some knowledge of the informal financial markets may permit the exploration of the limits of the formal financial institutions and permit the identification of the types of financial instruments and transactions for which there is a real demand and the formal financial institutions are not currently providing (Ghate 1994).

1.3 Operational definitions

One of the major difficulties that researchers encounter in the field of microenterprise is the lack of general consensus on the terms used. A wide variety of definitions are used, not just in Egypt, but worldwide. Hence, given the objective of this study and the focus on urban microenterprises, the following definitions will be adopted through this study.

1.3.1 Microenterprise working definition

There is no universal definition adopted for microenterprise, yet. The term microenterprise, as mentioned by Dichter (1999), started to appear as lending to the very poor people became of interest and their activities began to be seen as enterprises. Recognising that these were smaller than what had been called small enterprises, the term microenterprise emerged as shown in table 1.1. This table provides a brief historical development of the term used between the 1970s and the 1990s, and, hence, the thinking surrounding the developmental approach.

Table 1.1: Historical development of the microenterprise term.

- Small and medium industry promotion
- Small and medium enterprise promotion
- Entrepreneurship training
- Business development
- Small enterprise development
- Business training
- Business advisory services
- Small and Medium enterprise credit
- Microenterprise development
- Credit for microenterprises
- Microcredit
- Minimalist credit (credit only, credit first)
- Microfinance
- Financial intermediation for/with the poor

Source: adapted from Dichter (1999) page 8.

From the late 1970s to the very late 1980s when major donors discussed small and medium enterprise promotion, the operative term was business or enterprise and the thrust was on helping them grow and gain a greater share of the market. Then later it started shifting towards the microenterprise development. The developmental assumption was that small enterprises were important net generators of jobs and can contribute to the economic growth (Dichter 1999).

As mentioned by Buckley (1997) that studies which take the trouble to distinguish between micro and small enterprises are likely to yield more insightful and accurate results than those that do not. The criteria of distinction between micro and small enterprises, and larger scale enterprises vary from merely the number of workers, capital or assets to technology. Even by taking the number of workers alone as a criterion to define microenterprises, countries differed in what could be considered as the maximum number of workers in that sector. Probably at least as confusing is that each term micro, small and medium means so many different things to so many different people. There seems to be confusion between the acronym SME as small and medium or as small and micro enterprise. Even some researchers used SmE to stand for small and micro enterprises. This study adapted the same acronym used by the Small Enterprise Development journal, which used MSE to mean Micro and Small Enterprises and SME to mean Small and Medium Enterprises.

Very often, projects or organisations develop their own concepts of microenterprise and work accordingly, using different elements such as number of employees, assets, sales, location of workplace or participation of family labour. Microenterprises are fundamentally a different segment of the market. They are usually characterised by the family nature of their organisations and written records do not exist nor do they separate family from business accounts. Microenterprise activities are usually family-based, unregistered with any government institution, informal, and, therefore, lack the legal registration and financial reporting that the formal sector requires. They have inadequate assets or collateral; therefore, they are generally considered non-bankable (Lapar 1991; Johnson and Rogaly 1997). Furthermore, microenterprises are characterised by an unclear demarcation between production and consumption, and their dual nature reflects a complexity which conventional models of the enterprise and of the labour market are unable to capture.

In the absence of such a clear definition of microenterprise, given the objective of this study and since public surveys in Egypt do not provide data on microenterprises assets, the definition criteria will be based only on the total number of workers. Therefore, a microenterprise is deemed to be a business unit employing five workers or less. This definition is adopted by the major donor agencies working in the field of microfinance in Egypt.

It is worth mentioning that the microenterprise sector, based on the above definition criteria, comprises of diverse activities and is not a homogeneous sector. The inadequate understanding of the different microenterprise groups has often been a major source of confusion, and has led to the contradicting policy prescriptions. Therefore, this study distinguishes between three distinct groups, which are survivalist or subsistence activities, professional self employed, and microenterprises, as shown in figure 1.1. This division is mainly based on Dichter's definition of what is the business; which is the entity that has assets, location in which to operate and employees.

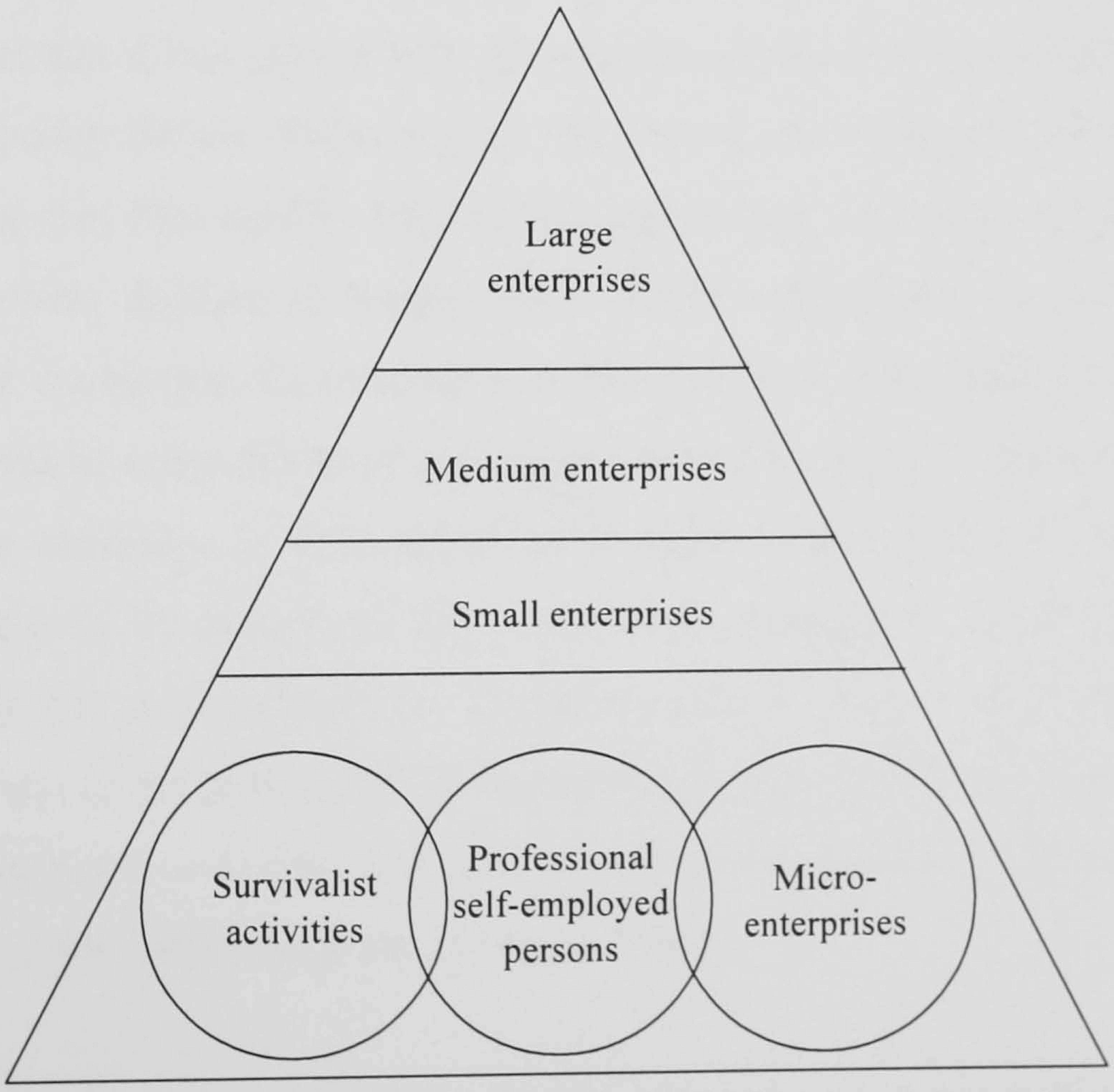

Figure 1.1: Business spectrum.

The first group, the survivalist activities are activities by people unable to find a paid job or get into an economic sector of their choice. They do not have a fixed location for their activities, and income generated from these activities usually falls far short of even a minimum income standard, with little capital invested. Poverty and the attempt to survive are the main characteristics of this category but are not a must (e.g. street vendors, vegetables sellers). This group are particularly appropriate target for those concerned with poverty alleviation (Mead and Liedholm 1998). A similar definition is also adopted by the Department of Trade and Industry (1995) in South Africa. The second group is the professional self-employed. This group usually has high levels of assets and human capital that enable it to get finance easily from banks e.g. doctors, consultants. The third group, which is the target of this study, is the microenterprise according to Dichter's previously mentioned definition of an enterprise.

1.3.2 The informal sector versus the formal sector

The meaning of the term informal sector has remained somewhat elusive despite the voluminous research and literature. It has been the subject to a lot of controversy despite the fact that it has gained wide recognition during the last two decades in the development policy debate (Sethuraman 1981; Mead and Morrisson 1996). The term informal sector was first used in 1973 in the report of an International Labour Office (ILO) employment mission to Kenya. Prior to this report, little or no account has been taken by development economists of the informal sector (Rauch 1991). This sector represents in some developing countries over 50 percent of the total economic activities. For example, in five countries in Latin America the estimates are as follows: in Bolivia 55 percent of the labour force belongs to the informal sector; Chile has 450,000 microenterprises; Colombia counts more than 1,500,000 urban microenterprises; in Ecuador 850,000 workers are employed in the informal sector, half of them in just two towns; and finally, in Peru 42 percent of the population of Lima belongs to the informal sector (Aropyor 1994).

It is also worth mentioning that the informal enterprises are not homogenous with respect to their compliance with the law. This sector is heterogeneous in terms of actors, activities, and scale. Actors in this sector include those who are own account workers, operating their own business with, or without family workers, employers in small businesses with few hired workers, wageworkers, and apprentices. Even some of small and medium size enterprises belong to this sector. Activities in this sector range from shoe shine services and street vendors, which contribute very little to output, to those involving substantial investment in skills and capital, such as manufacturing, construction and transport.

Despite the fact that the informal sector is difficult to define because of the difficulty in knowing what it constitutes, this study adopts what the literature describes as an empirical definition; the same criteria is used by El-Mahdi and Powell (1999). They equate the formality of an enterprise not just with the conformity to the principle legal system rules and regulations, but to all of the four main rules signifying formality, which are licensing, registration (commercial or industrial), social security subscription, and paying taxes on the basis of regular book keeping accounts. Therefore, if the enterprise abides by all the rules but the taxes paid are not based on regular bookkeeping, it will also be counted among the informal sector.

1.3.3 Microfinance

Microfinance is defined as a sector of formal, semiformal, and informal financial institutions providing financial services to the micro economy. These services comprise micro savings and microcredit, and perhaps other financial services such as micro insurance, leasing, and transfer services. It was firstly called microcredit and subsequently broadened to microfinance by the inclusion of savings services, and more lately insurance (Seibel 1998b). The term microfinance was coined in the microcredit summit in February 1997. Microfinance is not a new subject; it was practised well before the word microfinance was invented. Informal savings and credit schemes are widespread and carry different names in different countries. Microfinance consists of lending very small amounts of money both to individuals and to groups for very short periods of time. The amounts range from as low as 50 to 10,000 Egyptian pounds, although there is now a tendency to go higher in repeat loans and some microfinance institutions (MFIs) are lending as much as 15,000 to 25,000 Egyptian pounds.

For the purpose of this study, microfinance is viewed as the provision of small-scale financial services to businesses and households traditionally kept outside the financial system, rather than the more narrow view of microfinance as services for poor microenterprise owners. The microfinance literature is confined to poverty alleviation, although it should be widened to include the non-poor microentrepreneur as advocated by the economists Adams and Von Pischke in a numerous number of their research; the microfinance services should not be targeted exclusively to the poorest, but also to the underserved market niches in general. Furthermore, several studies could not find a perfect association between the microenterprise sector and poverty (El-Mahdi 1995; Hulme and Mosley 1996a; Mead and Morrisson 1996).

1.4 Statement of the problem and research hypotheses

Based on the study literature review, this section discusses briefly the two main research questions identified, and the testable hypotheses derived from these research questions as summarised in figure 1.2.

1.4.1 Statement of the problem

For a long time researchers and policy-makers have been discussing the financial problems facing MSEs. They have assumed that these problems are due to a limited supply of capital. Therefore, most of the research within MSEs finance have started from the supply side. In this context, financial problems in MSEs have been explained by reasons such as the information asymmetry experienced by the financiers, the high risk involved and the relatively high transaction and monitoring costs involved. A large number of questions remain unanswered in relation to finance and microenterprise development. Furthermore, existing research on MSEs has not isolated the importance of the different forms of finance and how these different forms of finance will affect the microenterprise growth in terms of income, employment and fixed assets accumulation. Also, research is required relating to the personal behaviour of microenterprise owners towards the different forms of finance. Therefore the study research problems or questions, based on the literature survey, are as follows:

- **Is there a relation between the growth of the microenterprises in urban Egypt and the different forms of finance, formal and informal?**

- **Is the primary explanation for urban microenterprise's lack of use of formal finance due to personal characteristics specific to the microenterprises' owners, or is the explanation more general in nature?**

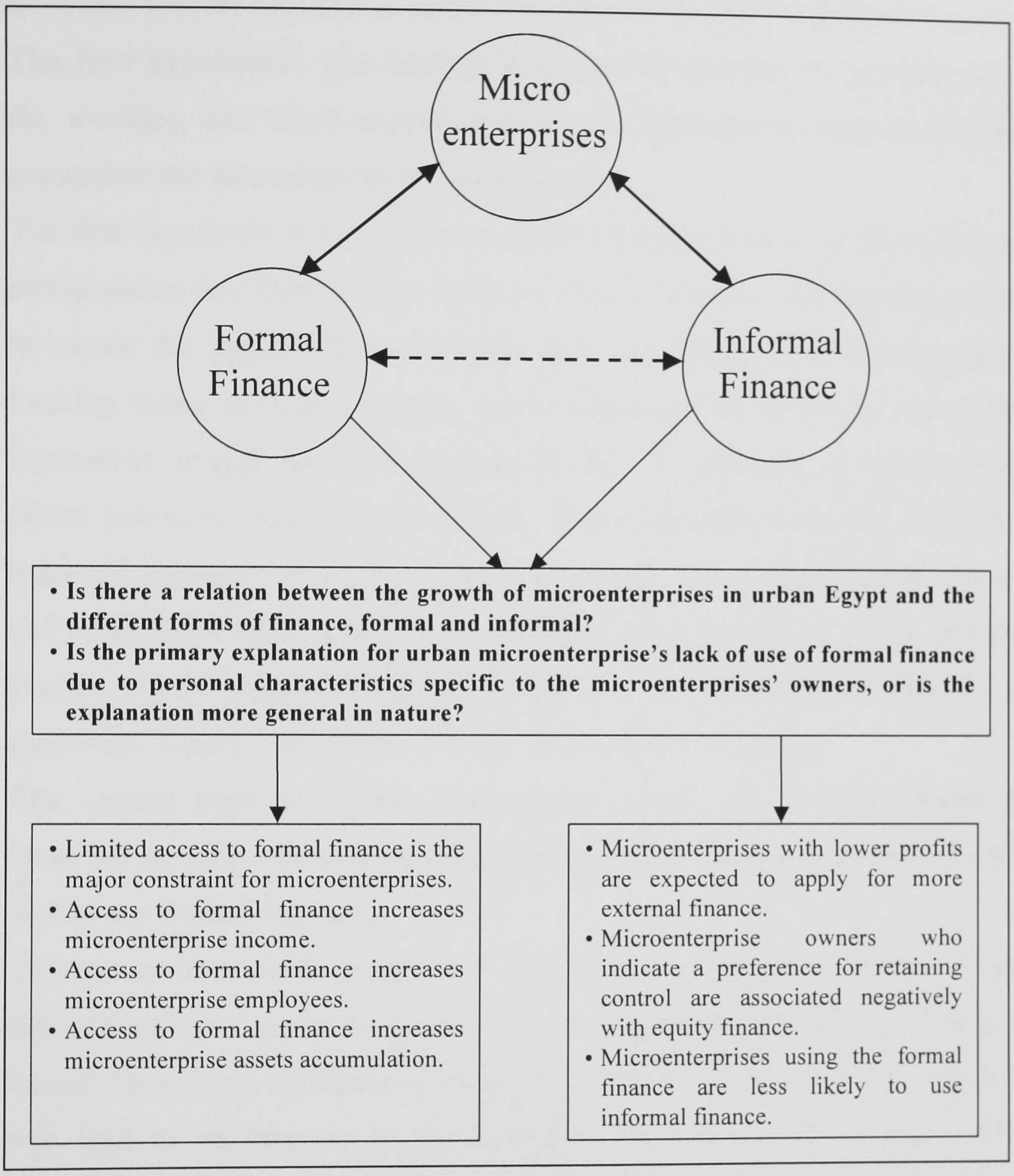

Figure 1.2: Research framework.

Figure 1.2 summarises the study research framework, which highlights the complexity of issues surrounding the financing of urban microenterprises.

1.4.2 Research hypotheses

Despite the theoretical literature on microenterprise finance being quite limited, some of the more recent theoretical work on small and medium enterprises has generated testable hypotheses that can be applied to microenterprise, as will be discussed in the following section. Therefore, based on the above research questions, and the misconception about microenterprises, an attempt was made to formulate the research questions into testable hypotheses within the Egyptian context as follows:

1. **The first hypothesis: The limited access to formal finance services to meet the working and fixed capital needs on a sustainable basis is the major constraint for microenterprise development.**

   The first hypothesis is based on the reported responses of most of the surveys of entrepreneurs that finance is the main constraint they face, and that they often fail to secure the capital they need and miss opportunities for business growth. Lacking access to formal finance, many enterprises must provide this financing themselves through their own savings, the help of relatives, or business profits; others turn to informal money lenders. They often face economic, institutional, legal and regulatory restrictions obstacles. Despite the presence of these multiple, and often interrelated, constraints, the widespread belief, on which policies to support microenterprise are based, is that the lack of finance, equity or debt, constitutes the main obstacle to the growth of microenterprise.

2. **The second hypothesis: Microenterprises which use formal finance have their net income increase significantly compared to microenterprises which do not use formal finance.**

   The second hypothesis is based on the common assumption adopted by many microenterprise finance programs. All microenterprise finance programs, and indeed virtually all aid financed initiatives, adopt the assumption that intervention will lead to an increase in the enterprise income and this income will be reinvested in the business, leading to growth of the enterprise and an increase in enterprise net worth. Furthermore, most microfinance impact studies regard income as a critical variable for measuring the impact of microenterprise credit services, and a general indicator of the microenterprise growth.

3. **The third hypothesis: Microenterprises which use formal finance have their employee number increase significantly compared to microenterprises which do not use the formal finance.**

   The generation of employment has been widely cited as an important potential result of microenterprise growth, and, thus, a potential impact of microenterprise finance. The contribution of microenterprises to the creation of new jobs has been a controversial issue around the world.

4. **The fourth hypothesis: Microenterprises which use formal finance increase their fixed assets accumulation significantly compared to microenterprises which do not use formal finance.**

   The accumulation of enterprise fixed assets may be one of the most important long-term alleged impacts of microenterprise finance, especially among the low-income borrowers. It is also alleged that the accumulation of enterprise fixed assets represents an expansion of the microenterprise resource base. These enterprise-specific resources can be used to expand and improve the microenterprise productivity.

5. **The fifth hypothesis: Microenterprises with lower profits are expected to apply for external finance compared to microenterprises with higher profits.**

   The fifth hypothesis is derived from arguments by several researchers that the microenterprise demand factors for finance take precedence over the supply factors, following a pecking order of internal resources, short-term debt, long-term debt then external equity. The pecking order hypothesis (POH) suggests that the enterprises' financing needs are hierarchical; i.e. there is a preference towards internal finance (Myers 1984). Therefore if microenterprises use internal funds initially, then it is expected that microenterprises with lower profits to go for external funds.

6. **The sixth hypothesis: Microenterprise owners who indicate a preference for retaining control are associated negatively with equity finance.**

   This hypothesis is also based on Myers' (1984) work on the pecking order hypothesis, where he suggests that the primary reason for the owners/managers of enterprises to use different sources of finance is their requirements for independence and control. Therefore, they follow a pecking order of using internal resources, short-term debt, long-term debt and then external equity. Therefore this hypothesis argues that the microenterprises owners' reluctance to widen finance is usually accompanied by being afraid of loosing control over the enterprise.

7. **The seventh hypothesis: Microenterprises using the formal finance are less likely to use informal finance.**

Policy makers often assume that individuals using informal finance are forced to do so because they lack access to formal financial services. Research in a large agricultural bank in Egypt however showed that many of the employees participated in informal financing. The popularity of the informal finance among people with easy access to banks may suggest that formal finance in Egypt may not be providing the types of financial services that people demand and they, therefore, create these services informally (Baydas et al. 1995). Furthermore, informal finance is often thought to be antidevelopment, exploitive, geared to consumption rather than investment behaviour and incapable of expanding to provide an appropriate volume and range of financial services (Pischke et al. 1983).

1.5 Research methodology design

In order to achieve the research objectives, the study adopted both theoretical and empirical approaches as follows:

- Firstly, the theoretical work is achieved by reviewing different theories of finance and its relevance to the microenterprise sector. This was done through providing a background on the current status of microenterprise finance in the developing countries in general, and in Egypt, in particular. Also small enterprise financing literature was reviewed to explore the most suitable model for this study.
- Secondly, the empirical study, which relied on primary data collected through a field survey in the form of direct interviews, was carried out by the author with existing formal borrowers and informal borrowers. The field survey uses a cross-sectional design that collects information at one point in time only. A quasi-experimental design, which enables us to look at what is already in place, is adopted.

1.5.1 Unit of analysis

The survey is confined to urban microenterprises in the private sector in Egypt as the unit of analysis. In practice, there is a large crossover and correlation between micro and small enterprises. Although many microfinance programs cover both microenterprises and small enterprises, this study includes only the microenterprise components of these programs. The survey concentrated on the urban microenterprises in the private sector only, as the rural sector has relatively received its fare share of direct credit programs since the 1950's from government and donor organisations.

1.5.2 Study sample

The sample size is limited to 100 microenterprises, but it was inflated by 5 to 10 percent to compensate for the potential non-responses. The limited funding, financial difficulties, and time limited the sample size, which was feasible to undertake. The sample is divided into two groups of microenterprises. The first group of the sample, which will be referred to as the formal borrowers or intervention group, is a sample of 50 microenterprises which receive loans (microcredit) from formal financial institutions. The second group, which will be referred to as the informal borrowers or control group, constitutes the rest of the sample, and it is a sample of 50 microenterprises which are non-recipients of formal credit, but could be recipients of informal credit. The formal borrowers group sample was randomly selected from lists provided by a formal institution (NGO). The informal borrowers group was selected according to a random sampling method that enables results to be generalised to the wider population targeted by the evaluation and allows for the comparison group to be as similar to the borrowers of formal finance as possible. The control, comparison, group was selected randomly, by using a Random Walk Client-Match Method as there was no list to sample from.

The informal borrowers group sample includes microenterprises that were not potentially getting any formal finance during the same period. To reduce the effect of confounding variables, a one to one matching was applied. Matching variables include location, in terms of exposure to market, type of activity, number of employees, difference in the number of employees not exceeding one, gender and the year of starting the business.

1.5.3 Data collection and analysis

Data has been collected by the author through direct interviews by using a questionnaire pre-prepared by the author. Face-to-face interviews were carried out at the different microenterprises locations to avoid conducting interviews at the premises of the formal financial organisation; as such a setting could restrict informants' responses and inhibit them from expressing views that might be in disagreement with that of the organisation. Furthermore, visiting the premises of a microenterprise gave the data more reliability.

The questionnaire is mainly quantitative, but also includes some qualitative questions to make it richer in its exploration of experiences, opinions, feelings, and knowledge, and tell us more about what is really going on. The questionnaire includes data on income and expenditure, and increase in employment. The questionnaire was formulated in such a way to avoid the difficulty of obtaining accurate data from microenterprises which keep no books, and who may be reluctant to share detailed or precise information with outsiders. The questionnaire has been initially tested on some colleagues and microenterprises, and their remarks and comments have been taken into consideration before carrying the final interviews.

The data collected were analysed with the help of a computer software package called the Statistical Package for the Social Sciences (SPSS). A wide variety of nonparametric statistical techniques were used with the quasi-experimental design. Descriptive statistics were applied to break down the information. Further analysis were carried out through the cross tabulation in order to investigate the relationship between variables. Then correlations between these variables were tested.

1.6 Major research obstacles

Firstly, the lack of detailed micro data on microenterprises and the funds they raise in private equity and debt markets, and in informal financial markets, are among the major constraints in this research. Also among the major problems is estimating the size of this sector in the absence of regular information and statistics that enable the proper selection of a representative sample of the community.

Secondly, only a very small percentage of microenterprises keep written records of any kind. Therefore, because of the poor record keeping and a lack of cross referencing, sources through formal channels that can be used to countercheck the reliability of the surveyed data information collected tend to be more qualitative than quantitative, which limits the choice of using a wide variety of statistical analysis.

Thirdly, time series work on the small-scale sector is relatively scarce (Cook and Nixson 2000). Furthermore, as will be shown in chapter five and chapter six, the results of similar studies in different countries can not be simply generalised, as the culture, environment and macroeconomic conditions have direct effects on the microenterprise sector, which is a reflection of the fact that this sector's decision is directly affected by the owners' personal characteristics. Surveys are more often conducted on an ad hoc basis at a point in time.

1.7 Organisation of the study

This study is composed of seven chapters. Chapter one is an introduction to the study and highlights the aims and motivations of the study, the research questions, the operational definitions concepts, the conceptual framework, the research design and the methodology and the major research obstacles faced during the course of the thesis work.

In chapter two, the existing literature on micro and small enterprises, with a particular focus on microenterprise finance, is reviewed. This chapter identifies the limitations in the existing literature, and, hence, provides a rationale for the research being undertaken.

Chapter three provides a background on the environment in which microenterprises financial markets, formal and informal, operate. It provides a thorough analysis of the local, social and economic structure, and macro-level trends of Egypt's economy.

It also provides an evaluation and information on the operating Microfinance Institutions (MFIs), formal and informal, in Egypt, highlighting the existing MFIs' service as to who uses them and to what effect. In addition, it provides a brief discussion on alternative methods of finance, notably informal finance, and explores the policies instituted by the government for the micro and small enterprise sector. It also discusses the current research and the literature available on microenterprise finance in Egypt.

Chapter four is the start of the field study and discusses the methodology applied. It gives a detailed description of the methodology chosen and the basis of the data selection. It provides a brief discussion of the data constraints and the obstacles faced during the fieldwork. The purpose of this chapter is to highlight the specific issues investigated and the methodological techniques employed.

In chapter five the survey results are analysed and presented, mainly by the means of descriptive analysis (e.g. cross tabulation, chi-square test, and Mann-Whitney U test) and the results are compared with studies undertaken in other countries.

Chapter six carries the analysis one step further by testing the research hypotheses. In addition it illustrates how the research carried out relates to other work undertaken in this field in different countries.

Chapter seven provides a summary of the thesis, draws conclusions, and offers recommendations at the theoretical level, the policy level and the financial institutional level. The recommendations are based on the findings of this study. Areas for future study and research are also considered.

Chapter Two: Microenterprise Finance - Literature Review

2.1 Introduction

This chapter examines the literature on microenterprise finance, where in the developing countries research on both the supply and demand for finance in relation to small enterprises has been empirically-based, and has been preoccupied with gathering information on the characteristics of small enterprises and lending institutions, rather than on testing hypotheses that would improve the understanding of the relationship between finance and MSEs (Baydas et al. 1997b; Cook and Nixson 2000; Romano et al. 2000). Fischer et al. (1993) point out that there is a need to articulate and to test theories rather than merely accumulating empirical findings so that knowledge might be more systematically developed. Most of the theoretical work on small enterprise finance has been undertaken in developed countries, particularly the US and the UK. A large proportion of this work has tended to concentrate on enterprises that, in terms of size, lie towards the upper end of the spectrum, where the range of ownership and financing options become wider, and not on the lower end, where the majority of the enterprises are known as microenterprises, as was previously shown in figure 1.1. Furthermore, in the developing countries research is mainly focused on the supply side, i.e. it is mainly concentrated on studying microfinance institutions' (MFIs) delivery methodology and its impact. The review of the literature on MSEs provides evidence of the typical interdisciplinary nature of microenterprise finance research; academic commentators in the fields of economics, geography, sociology, psychology, and management have contributed to this field.

The literature review is divided into a theoretical literature review, which is dealt with in this chapter, and an empirical literature review, which will be dealt with in chapter five and chapter six. The theoretical literature review focuses on the existing theoretical models as well as on models applicable to the analysis of the determinants of the demand for microenterprise finance. As for the empirical literature review, it looks at the various empirical studies to validate some of the results of this study. Hence, this chapter firstly discusses the historical justification for supporting the development of micro and small enterprises' finance and the major school of thoughts behind these developments. Secondly, a number of theoretical approaches are critically evaluated to decide on their relevance to the microenterprise sector. Thirdly, the missing middle link in most of the models, which is the informal finance, is discussed, and finally a summary and conclusions are given.

2.2 The development of the concept of microenterprise finance

The efforts to expand access to financial services for microenterprises have been recognised as an effective strategy to enhance the economic activity of low-income people. Hence, the development communities have been focusing on the aspect of providing finance for microenterprises in order to achieve the twin goals of job creation and human development, as was shown in table 1.1. Finance to micro and small enterprises have become a fashionable topic in development economics. A large body of literature has emerged that provides justification for supporting the development of MSEs through finance, mainly focusing on providing microfinance to the poor whether household or business entities (Dichter 1999). Microenterprise finance should not be always equated with poverty reduction, as argued in chapter one, without empirical validation (Hulme and Mosley 1996a). The reaction towards providing microcredit to the poor is mixed. As mentioned by Hulme (2000, p79):

> "At one end of the spectrum are studies arguing that microfinance has very beneficial economic and social impacts (Holcombe, 1995; Hossain, 1988 Khandker, 1998; Otero & Rhyne, 1994; Hashemi et al, 1997). At the other are

writers who caution against such optimism and point to the negative impacts that microfinance can have (Adams & Von-Pischke, 1992; Buckley, 1997; Montgomery, 1996). In the middle is work that identifies beneficial impacts but argues that microfinance does not assist the poorest, as is so often claimed (Hulme & Mosley, 1996a; Mosely & Hulme, 1998)."

2.2.1 Justification and historical development of microenterprise finance

Recent development efforts to promote the development of microenterprise finance can be traced to the use of the financial system as a one-way street for moving financial resources to borrowers. For a long time, donors and practitioners have used microcredit activities to alleviate poverty by creating income and jobs, as argued by Dichter (1999) and presented in chapter one. This is based on an assumption that by integrating the low-income people into the economic circuit, finance will automatically promote development. The concept of reducing poverty in developing countries through the provision of loans by specialised financial institutions attracts much interest from policymakers, as it appeals to the left as being a direct approach to alleviating poverty. It also appeals to the right as being an approach for achieving the efficiency objective and facilitating the emergence of independent self-sustaining enterprises, while providing incentives to work (Hulme and Mosley 1996a; Mosley and Hulme 1998; Morduch 1999).

This concept of providing formal finance to the low-income people is not new. It began in the 1950's when Keynesian economics inspired many governments to design fiscal interventions at the macroeconomic level. A shortage of the working capital was regarded as one of the biggest obstacles to development. And, hence, foreign assistance to developing countries after World War II frequently took the form of small credit projects.

Patrick (1983) enhanced the theoretical basis for intervention through the financial system for the sake of development in a 1966 article describing the advantages and the potentials of supply leading finance. Patrick (1983) suggested that the establishment of financial institutions and the provision of loanable funds, in advance of established demand, stimulate the pace of investment and economic activity, as this represents an opportunity to induce real growth by financial means. Patrick's work was followed by increased government involvement in the rural credit system. The belief that rural activities are essential elements in the process of economic development increased direct interventions in the rural credit system. Hence, targeted credit programs, interest subsidies, national development banks, specialised agricultural credit institutions, commercial banks, rural banks, co-operative banks and government-supported projects and policies became widespread in the 1960s (Bakhoum et al. 1989; Hulme and Mosley 1996a; Morduch 1999).

By the early 1970s, government agencies were the predominant method for providing productive credit to those with no previous track records. The world food crisis and the mounting concern for involving the low-income people in economic development added to the attractiveness of supplying rural credit through government institutions. However, these direct interventions have generally been disappointing and have tended to retard the development of financial services in rural areas. The state-owned rural financial institutions dependent on government subsidies have crowded out the informal finance. Many of these agencies have been unsuccessful in the financial sense, as most of them had arrear rates of more than 50 percent, according to a survey by the World Bank in the mid 1970's (Hulme and Mosley 1996a; Johnson and Rogaly 1997; Yaron et al. 1998). Furthermore, those projects were often patterned after financial institutions or programs in the United States or Europe, and were based on the assumptions that target groups were too poor to save, and that the informal finance systems charged excessive borrowings fees and played a small role in the provision of financial services to small farmers (Adams and Von-Pischke 1992).

In the 1980s, major donors such as the United States government and the United Nations organisations became more concerned about the quality of their interventions. With the experience they have gained on the limits and possible negative effects of the rural credit programs, and after the evaluation of their direct intervention policy, they started focusing on building the institutional capacity of what is known as microfinance institutions (MFIs) (Gonzalez-Vega 1994; UNDP

Special Unit for Microfinance 1999). The microfinance term started to appear as an extension of the credit programs, and became the most fashionable term among the development community. Microfinance arose as a response to doubts and research findings about the government's delivery of subsidised credit to poor farmers. The microfinance sector has primarily been developed as a response to the inability or apathy of commercial banks and the formal financial system to serve the needs of low-income households and microenterprises. Also during the 1980's, interest in the informal finance sector started to emerge, despite the fact that informal finance has been practised over thousands of years. People have always been borrowing, lending, and saving for as long as there has been money, and in kind, before; they have done this within their own communities, using their own systems and methods, without any external assistance or resources. For example, the institutions of rotating savings are ancient and in many parts of the world they are an integral part of the local micro economy (Seibel 1998a). In Egypt they are referred to with its own vernacular term *gam'iya* as will be discussed in the next chapter.

In the 1990s, commercial banks started to show an interest in this emerging industry encouraged with the relative success of the microfinance institutions, such as Grameen Bank in Bangladesh. Furthermore, the microcredit summit held in Washington DC in 1997 was sponsored by MasterCard International, Citicorp Foundation, the Monsanto Fund and the Charles Stewart Mott Foundation. In order to have a clear understanding of what is meant by microenterprise finance, the following section discusses the two major schools of thought or approaches in microenterprise finance literature.

2.2.2 Microenterprise finance schools of thought

There are two major schools of thought regarding microcredit which have their significant impact on the development of the microenterprise finance concept. A brief discussion of the major features and impacts of both schools is given in this section.

2.2.2.1 Welfarist thought

Welfarists distinguish themselves from the other approach primarily by their value-based commitment to serve the very poor. They concentrate on the social and economic impacts. They emphasise the depth of outreach. and focus on immediately improving the well-being of the poor. They are less interested in banking per se than in using financial services as a means to alleviate directly the worst effects of deep poverty among participants in microcredit programs and communities, even if some of these services require subsidies. Their objective tends to be self-employment of the poorer of the economically active poor, especially women, whose control of the modest increase of income and savings is assumed to empower them to improve the conditions of life for themselves and their children. The centre of attention is the family. The most prominent examples of Welfarist institutions are the Grameen Bank in Bangladesh and its replicates elsewhere, and FINCA village banking programs in Latin America. and, more recently, in Africa and Asia (Woller et al. 1999).

As seen from the above paragraph, the Welfarist approach, the poverty lending approach, claims that the overall goals of microfinance should be poverty reduction and empowerment of low income people.

2.2.2.2 Institutionist thought

It is popularly known as the Ohio school in honour of a group of economists at the Ohio State University (Hulme and Mosley 1996a). The Institutionist approach focuses on creating financial institutions to serve clients who either are not served or are undeserved by the formal financial system. The emphasis lies on achieving financial sustainability and breadth of outreach, with the number of clients taking precedence over the depth of outreach. Furthermore, the level of poverty reached is assessed and positive client impacts are assumed. They believe that credit plays a facilitating and not a leading role in the process of economic development; therefore, credit is not an effective tool for helping most poor people to enhance their economic condition. They believe in the efficacy of informal financial institutions in developing countries, as subsidised programs are inefficient and undermine savings. They, also, place emphasis on the crucial importance of savings mobilisation. They have great doubt about the effectiveness of microfinance institutions set up by governments, and oppose the idea of targeting loans on specific sectors (Hulme and Mosley 1996a; Morduch 1998; Woller et al. 1999).

The Institutionist position is articulated in virtually all the literature coming out of the Ohio State University Rural Finance Program, the World Bank, the Consultative Group to Assist the Poorest (CGAP) in the World Bank, and the USAID. Their position is a direct outcome of the experiences of Rural Development Institutions (RDIs) during the 1960s and 1970s, and the lessons derived thereof by researchers at the Ohio State University Rural Finance Program (Woller et al. 1999).

As seen from the above paragraph, the Institutionists focus on the sustainability, out reaches of microfinance institutions and the role of the informal finance sector.

2.2.3 Micro and small enterprise finance research

As could be seen from the previous historical developments of MSE finance, for a long time researchers and policy-makers have been discussing the financial problems faced by MSEs. Overall, the views concerning the major problems faced by MSEs have varied; it has been argued that they face severe problems in attracting external finance, whether debt finance or equity finance. Researchers and policy-makers have assumed that these problems are due to a limited supply of finance. Therefore, most of the research within MSEs' finance has started from the supply side. Finance has most often been identified as an inhibiting factor as part of a larger investigation into a wider range of variables.

This approach, which is supply focused, leads to the concentration of most of the literature on MSEs' finance around two major areas. The first area is the theoretically based studies examining the behaviour of various lending institutions, as suppliers of finance to MSEs. In this context, financial problems in MSEs have been explained by reasons such as the information asymmetry experienced by the financers, the high risk involved in financing small businesses, and the relatively high transaction and monitoring costs involved e.g. Hoff et al. (1993) and Stiglitz and Weiss (1981). The most common explanation given by these studies was imperfect information, which can lead to restricted flows of finance whether the problem lies within the enterprise, through poor record management or in financial institutions, through the relatively high costs associated with gathering information on smaller enterprises.

The second area of studies has attempted to study the loan delivery and recovery system through examining the implications of the different financial structures found in different sized enterprises. In part, these are based on field surveys, which have attempted to catalogue the range of finance sources available to MSEs in low-income countries through an empirical framework, and to examine their implications for growth and investment. Most of the literature is based on a descriptive rather than a diagnostic framework, e.g. Cortes et al., Levy and Kilby et al. in Baydas et al. (1997b) and Laper (1991). The majority of these studies identify finance as the primary obstacle to develop MSEs, as it is mainly based on the entrepreneurs' subjective responses. Entrepreneurs when asked about their access to formal finance typically respond by claiming a need for credit at a reasonable price. These results were contradicted by other studies such as McLeod (1992), which mentioned that these studies are rarely specific enough to show how the enterprise owner would respond to a rigorous subset of loan terms and conditions. Under increasingly rigorous terms and conditions the lack of entrepreneurial ability makes access to finance difficult, rather than that the lack of access to finance being the factor that holds back entrepreneurship.

Furthermore, those research areas neglected the individual characteristics and attitudes of the MSEs' owners, such as the level of education, age, and family background, which are very important factors in the decision of the enterprise owners' use of alternative financial services. They consider the formal financial contracts that the MSEs use as being exogenously predetermined, and not a function of the overall mix of financial services chosen by the MSEs' owners. They mainly focused on the traditional economic view of MSEs' financing, despite the fact that the relationship between the MSEs' owners and the financial community is not purely an economic one. They try to explain the success and failure of parties in conducting value-increasing transactions by referring to the mechanics of supply and demand curves and agency theory, which represent just one element of the small enterprise financing issue. It is therefore necessary to integrate an understanding of the economics of small microenterprise financing with an understanding of the personal choice of the enterprise owners (Lapar 1991; McMahon et al. 1993; Read 1998).

Despite the fact that numerous projects and policies were initiated to assist MSEs over the past decade, theoretical models that deal specifically with microenterprise finance are limited. There is a lack of understanding about the MSEs' effective demand for alternative financial services under the circumstances found in many developing countries. The literature in this area is not only limited, but it is predominantly anecdotal and descriptive (Howorth 1999; Romano et al. 2000). This apparent gap in the existing literature can be attributed to the relatively unexplored and inadequate research undertaken in this area. This deficiency is particularly evident in the investigations into factors that influence financing decisions of microenterprise owners and how the different forms of finance, formal and informal, might stimulate microenterprise development. In the absence of theoretical models specific to the microenterprise sector, alternative models that can be used to analyse microenterprise finance are looked into.

2.3 Microenterprise finance models

Compared to large enterprises, theoretical models relating to MSEs' financing decisions seem to be growing, but are relatively weaker (Baydas and Graham 1995; Baydas et al. 1997b; Romano et al. 2000). There are some studies that tried to identify the financing choices and the reasons influencing the determinants of finance for small business owners. Among those studies is the one by Ozer and Yamak (2000) on small hospitality enterprises in Turkey, where they attempted to investigate the source preferences for financing the ongoing operations by combining finance theory and small business management literature. Also among those few studies that attempted to adopt an interdisciplinary framework that investigate and aim to integrate divergent theories within a broad-based framework to help explain financing decisions by small business is the one by Romano et al. (2000) on small business, family enterprises, in Australia, where they tried to find how the owner-manager background characteristics influence the capital structure decision making.

Romano et al's study attempted to provide a basis for explaining the financing behaviour of family enterprises by relying on several theoretical frameworks and integrating these theories. The theories included capital structure theories grounded in finance paradigms. Also along the same line, a study by Baydas and Graham (1995) tried to develop an empirical model based on data collected from low-income countries, where personal values and behavioural intentions were viewed as a determining behaviour. Baydas and Graham's study attempted to test the influence of personal characteristics on capital structure decision-making.

The fact that small enterprises operate differently than large ones is often stressed in these studies. They suggest that the characteristics of the enterprises, the attributes of the owners, and the transactions costs of the alternative sources of financing simultaneously determine the capital structure of the enterprises. Similarly, Hutchinson argued that the factors limiting demand for finance in owner-managed enterprises have often been neglected by an over-reliance on the arguments which attempt to explain small enterprise financing problems solely in terms of the lack of access to the supply of equity and debt (Cosh and Hughes 1994).

As these studies draw extensively on the mainstream capital structure theory that has been developed mostly within the scope of large enterprises, the explanations of capital structure processes will be sought in understanding the impact of finance on the microenterprise sector. Hence, in the next section the general assumptions in the capital structure theory and their applicability to small enterprises are discussed.

2.3.1 Capital structure

There exists a large body of theoretical and empirical literature in finance and economic disciplines relating to capital structure decision-making processes, which mainly focus on listed companies. Contemporary theory of capital structure is based on Modigliani and Miller's seminal work in 1958 on the effect of capital structure on company value. Where in a perfect capital market, there would be no difference between internal and external financing of any investment project; therefore, the enterprise can regard internal and external finance as perfect substitutes. This theory assumes perfect markets and perfect competition in which companies operate without taxes or transaction costs, and where all relevant information is available without cost. Several researchers have criticised Modigliani and Miller, such as Grabowksi and Mueller, on the grounds that their theory assumes rational economic behaviour, perfect market conditions, and that the owners' goals are targeted only at maximising profits (Pike and Neale 1996).

There are two main approaches, or schools of thought, to the capital structure choices of businesses. Myers (1984) distinguished them as the static trade-off and pecking order hypothesis. In the static trade-off theory, an enterprise is viewed as setting a target debt to equity ratio and gradually moving towards it. This approach suggests that there exists an optimal capital structure and that the enterprises have target debt-to-equity ratios. The Pecking Order Hypothesis (POH) emphasises that enterprises prefer internal to external financing and debt to equity. In the pecking order theory, an enterprise has no well-defined target capital structure. This approach suggests that there is a hierarchical preference over sources of financing. While the former approach assumes a static stance, the latter takes on a dynamic approach to capital structure decisions.

2.3.1.1 The static trade-off theory

The enterprise's optimal debt to equity ratio is viewed as that which would minimise the enterprise's composite cost of capital. In other words, an enterprise's optimal debt ratio is determined by a trade-off of costs and benefits of borrowing. Static trade-off theory suggests that management aims to maintain a target debt–equity ratio. Modigliani and Miller in Pike and Neale (1996) proposed that in a perfect capital market, only investment decisions are important in pursuit of wealth maximisation. Various perspectives such as the tax based theory, the signalling theory, the agency theory and information asymmetry are used to explain the static trade-off of the enterprise. The tax-based theory hypothesises that enterprises choose their debt-equity ratio by trading off the benefits from tax reduction on interest payments against the costs of financial distress due to accumulating more debt. Some researchers used this as a signalling method to the enterprise status. Also, the agency theory arguments have led to propositions suggesting that a trade-off between the opposing effects of benefits of debt finance and the costs of financial distress means that an optimal capital structure exists.

Many of these hypothetical assumptions upon which these models are based, which includes costless, competitive, and complete capital markets, do not hold in developing countries. Furthermore, they have focused on particular problems when owners and managers are functionally separated and costs arise for owners in their attempts to ensure that business is managed in the owner's interest (Cosh and Hughes 1994), which is not the case with MSEs, where in most cases owners and managers of small enterprises are the same. In addition to the fact that most field researches (e.g. Baydas, 1995; Reid 1996; Baydas, 1997b) revealed that MSEs' owners are not concerned with an optimal debt level of the enterprise. Hence, this theory has limited applicability to MSEs and an alternative approach that does not assume a perfect capital market structure may be more applicable.

2.3.1.2 The pecking order hypothesis

Over 17 years ago, Myers (1984) stated that financial theories do not adequately explain financing behaviour. He provided an alternative explanation for capital structure based on information asymmetry in which enterprise managers or insiders are assumed to possess private information about the characteristics of an enterprise's return stream or investment opportunities. He observed that managers/owners follow a pecking order, in choosing sources of finance, in which internal funds are preferred, followed by debt, and then as a last resort a new issue of ordinary shares. The pecking order hypothesis is hardly new: Donaldson mentioned it earlier in a 1961 study of the financing practices of a sample of large corporations. The POH is a dynamic theory and implies that individual enterprises may have different debt to equity ratios depending upon the matching of their profitability with their investment opportunities. Low profit high-investment opportunity enterprises will tend to have higher debt and ultimately issue more equity than high-profit low investment opportunity enterprises (Myers 1984).

There are two different ways of explaining the POH. The traditional view argues that the pecking order can be observed under high transaction costs, taxes, and agency costs. The other explanation proposed by Myers (1984) assumes that the enterprise insiders have more information than outsiders. To avoid paying too much for new financing, managers would secure new financing under pecking order. Myers was among the first researchers who tried to explain financing behaviour by incorporating the private information possessed by insiders, or managers, into capital structure model.

Despite the fact that the POH was used in relation to listed companies, Cosh and Hughes' (1994) making use of the insights of the POH shows that the financial structure of the smaller business compared with larger ones is consistent with a pecking order hypothesis. Furthermore, findings of several studies which attempted to identify the capital structure of small enterprises (e.g. McMahon et al. (1993), Cosh and Hughes (1994), Islam et al. (1994), Baydas and Graham (1995), Hamilton and Fox (1998), Ozer and Yamak (2000) and Romano et al. (2000)) show some consistency with the concept of the POH and found it equally applicable to small unlisted companies, which cannot raise additional funding through the issuing of stock to the public. The findings of these studies showed that internal financing is assumed to be preferred to external financing, such as overdrafts, trade credit, leasing and hire purchase as shown in figure 2.1.

Source of small enterprise finance					
Internal		**External**			
Personal savings/ Retained profits	Family/Friends	Bank overdraft	Bank loan	Factoring	Equity
--▶ **Decreasing preference**					

Figure 2.1: Diagrammatic representation of the POH applied to sources of small enterprise finance, adapted from Read (1998) page 51.

These findings have been explained using Myers' (1984) reasoning, which implies that managers/owners are guided by a pecking order when choosing among financing opportunities. The most popular reason for explaining this behaviour, as mentioned by McMahon et al. (1993), Cosh and Hughes (1994), Baydas and Graham (1995), and Read (1998), was due to control, which is the desire to avoid external interference and maintain independence. The amount of debt or equity sought is determined, to a large extent, by the enterprises' owners/managers goals of protecting the control of the enterprise. This is expected given the fact that in many cases the entrepreneur has established a small enterprise to be self-employed and to avoid the control of outside directors. Ownership and management are almost the same in small enterprises, and usually they have a personal financial stake in the business. They therefore tend not to dilute ownership or control over the assets. The admission of additional owners would therefore be very low in the owner's pecking order. Furthermore, owner-managers prefer internal funds as this form of funding ensures the maintenance of control over operations and assets. Where debt funding becomes necessary, debt will be sought that does not constrain management. It has been suggested that independence is so important to some small enterprises that they will choose it at the expense of access to more flexible forms of finance (Myers 1984; Cosh and Hughes 1994).

Although the previous mentioned studies used aggregate enterprise data to compare small and large enterprises, and concluded that the results are broadly consistent with the pecking order hypothesis; a study by Howorth (1999) found that the POH does not completely explain the owner's choice of finance. This is because the use of a particular source of finance is not shaped purely by small enterprise owners' access to the sources on offer, but also by their wishes. In relating this to the pecking order, it is probably expected that a truncated pecking order will exist for individual small enterprises as shown in figure 2.2. Howorth (1999) observed that the pecking order dominates decision-making at each point where additional funds are required. He suggests that the personal attitudes and objectives of the owner managers were the most important determinant where truncation points would occur, as shown in figure 2.2. He concludes that the financial structure of small enterprises reflects their owners' personal views as much as constraints by the suppliers. Hence, the owner managers' demand for finance take precedence over supply factors, following a pecking order of internal resources, short-term debt, long-term debt and then external equity (Howorth 1999).

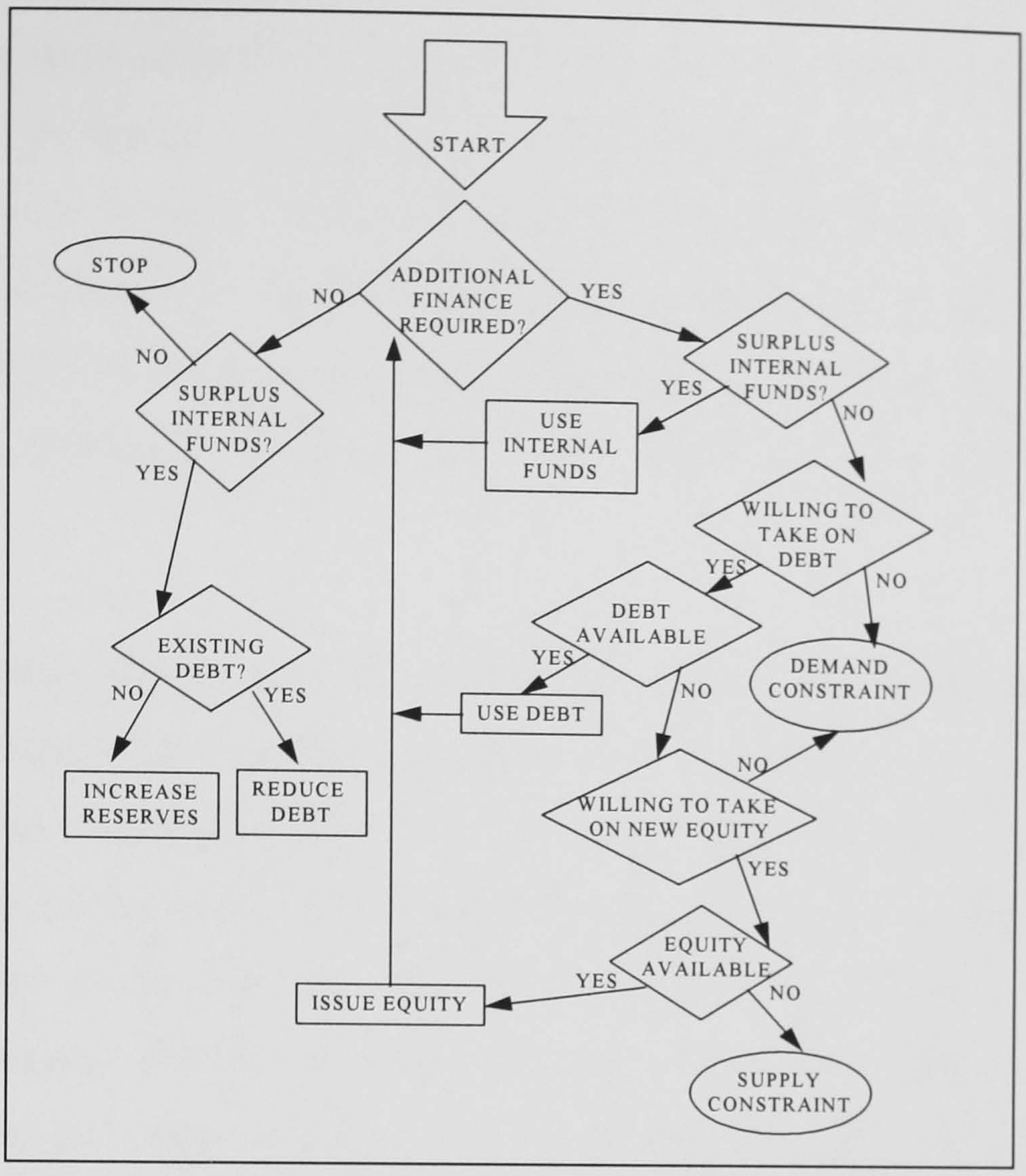

Figure 2.2: Small enterprises finance: decision making process (Howorth 1999).

What could be noticed from this section, and as mentioned by Hamilton and Fox (1998), is that if small enterprise owners in different countries reveal such a preference ordering, then perhaps the notion of the finance gap needs to be reconsidered. In other words, the debt levels in small enterprises do reflect a demand-side preference ordering and are not just a manifestation of the supply-side deficiencies. As mentioned by Norton (1991, p. 174):

> "In small business and entrepreneurial enterprises, managerial beliefs and desires will play an especially important role in determining capital structure ….. and models must include the role of management preferences, beliefs, and expectations if we are to better understand capital structure policy."

2.3.2 The financial life cycle approach

The life cycle approach, or the growth model of the small business concept, can also shed some light on the financial needs of the enterprise. This model helps in determining the demand for financial services by MSEs at various stages of their life cycle, and the most appropriate way of responding to such a demand. A small enterprise may be thought of as having a financial growth cycle in which financial needs and options change as the enterprise grows, gains further experience and becomes more transparent. The financial life cycle of the small enterprise concept, as found in the work of Weston, is a relatively simple idea, which provides a useful framework for looking at the development of a small enterprise and it's financing (Haidar 1992).

Berger and Udell (1998) discuss the financial growth cycle of different enterprises, they point out that sources of finance depend on the enterprise size, enterprise age, and information available. Hence, the different capital structure is optimal at different points in the cycle. The enterprise's actual debt–equity ratio varies over time, depending on its need for external finance. Hence, the need for different sources of finance changes according to the enterprise's different stages of development in the financial life cycle. Hutchinson and Ray have reviewed the financial life cycle of small growth enterprises relating the stage of development to the financial stress factors associated with each stage, as shown in table 2.1 which gives a view of the financial life cycle of smaller growth enterprise (McMahon et al. 1993).

The financial life cycle of the enterprise, which is referred to in some of the literature as Evans' hypothesis, suggests that the financial life cycle passes through at least three stages of growth, each stage has different types of financing from different sources. These various types of financing are not all utilised at once when the enterprise is established; they evolve as the enterprise grows and develops. When the enterprise reaches maturity most of these types of finance, which can be utilised, are based on the financing needs of the enterprise and primarily on the financing decision. These activities grow in a very systematic way: i.e. cash is an extremely important resource at the start, it becomes easily manageable at the success stage, and is a main concern again if the organisation begins to grow. As illustrated by table 2.1, it is only during the later growth phases that more diverse sources of finance are required and used. There might be other factors that prevent businesses from utilising these sources, such as constraints from the business itself or from the market (Haidar 1992).

On the other hand, Berger and Udell (1998) emphasise that the growth cycle paradigm is not intended to fit all of the small enterprises, and that the enterprise size, age, and information availability are far from perfectly correlated. Also, Miller and Friesen in Romano et al. (2000) found that while the stages of the life cycle are internally coherent and different from one another, they are by no means connected to each other in a deterministic sequence.

Table 2.1: A view of the financial life cycle of a smaller growth enterprise.

STAGE	SOURCES OF FINANCE	POTENTIAL STRESS FACTORS
Inception	Owners' resources	Undercapitalisation
Growth I (take-off)	As above plus: retained profits, trade credit, bank loans and overdrafts, hire purchase, and leasing	Over trading and recurrent liquidity crisis
Growth II (rapid growth)	Owners' resources plus: longer-term debt finance from financial institutions.	Finance gap
Growth III (slow down)	Owners' resources plus: equity finance from partnerships, venture capital sources, and new issue market	Loss of control
Maturity	All sources available	Maintaining return on investment (ROI)
Decline	Withdrawal of finance, enterprise taken over, share repurchase, or liquidation	Falling ROI

Source: adapted from McMahon et al. (1993) page 163.

Of course, still a large portion of MSEs may not require significant amounts of additional external finance because they are able to meet their requirements with self-generated finance, internally, or because the actual need for it does not actually exist. As mentioned by McLeod (1992), it is misleading to view small enterprises as being forced to rely on either very limited self-finance or exorbitantly expensive moneylenders' loans, which is the informal finance that will be discussed in section 2.4. McLeod believes that the financing options of small enterprises steadily widens over time as they build up their assets and their reputation. The longer a business continues to operate successfully, the wider the financing options are opened to its owner. Hence, the magnitude and composition of the MSEs' effective demand for finance will typically vary significantly over its life cycle (Liedholm 1992). Given the above views of the financial life cycle, it may be said that the financing of a small business evolves in stages together with the growth and development of the business. The need for external finance is shaped by the age and size of the enterprise, as the smaller the scale of the business, the less finance, particularly external finance, is required. Furthermore, the need for finance is also linked to the growth objectives of the owner-manager (Read 1998). Hence, the behaviour perspective role in determining the need for finance should be investigated.

2.3.3 Behavioural science perspective approach

A critical problem in most of the assessment of the small enterprise sector studies is that they consider the formal financial contracts they use as being exogenously predetermined. MSEs' use of alternative financial services is determined by a number of factors including the characteristics of the enterprises' owners as well as the environment they operate in.

As mentioned by Myers (1984) and Norton in Romano et al. (2000), neither the financial theories nor the empirical studies indisputably explain the critical factors that affect the owners' or managers' financing decisions. Furthermore, because the economic and the social finance literature tend to remain separate from the behavioural sciences literature, little attention has been given to integrating economic and behavioural theories. The individual characteristics and attitudes of a small enterprise's owner are very important factors in the acquisition of the business's capital, but are often neglected in the research carried on the finance gap, which is defined to be the unwillingness on the part of suppliers of finance to supply it on the terms and conditions required by the small enterprise (Read 1998). As mentioned by

Ozer and Yamak (2000), the order of financing choices is expected to reflect contextual characteristics and managerial preferences of the small enterprise owners.

Understanding the human behaviour is fundamental to understanding how enterprises function, whether they are micro, small, or large enterprises. Characteristics such as personality, background, education and experience will all impinge on the financial decisions made by the enterprise's owner and how the external lenders will receive them. Most of the previous finance theories, that have been discussed, have an underlying assumption that all persons are profit maximisers. They are based on the traditional economic model of human behaviour, where mangers/owners are seen as short-run profit maximisers. The whole focus is on one characteristic of the human behaviour, greed, or the selfish desire for wealth. Despite the fact that such an assumption offer a simple approach to model building, it does not fully explain the flow of capital, as making money is not always the main motive. Hence, there is a need to integrate the economics concepts with concepts from the social processes (Sargent and Young 1991; Pike and Neale 1996).

Jensen and Meckling (1994) developed a more realistic model of human behaviour, which is termed the Resourceful, Evaluative, Maximising Model (REMM). This model differs from the traditional economic and financial assumptions, which emphasise rationality and profit maximisation, with regard to its view about people. This model assumes that people are resourceful, self-interested maximisers, and rejects the notion that they are only interested in making money. They care not only about money, but also about most things, e.g. respect, power, quality of life, love, and the welfare of others. Jensen and Meckling (1994) also suggest that the people's preferences and tastes must be specified and the details must be added to the tailored models to serve as a decision guide in specific circumstances. Therefore, by combining these assumptions with knowledge of the opportunity set from which people are choosing in any situation this leads to a powerfully predictive model.

Recently the entrepreneurship research on small enterprise financing has begun to move away from the traditional or efficient market assumptions about enterprises' financing, as mentioned in the previous section, towards the recognition of the role of individuals and their interactions in investment decisions (Sargent and Young 1991).

Sargent and Young assume that the raising capital is embedded in a psychosocial matrix. Thus, social factors may constrain or provide access to requirements such as information as well as financial resources. Furthermore, they suggest that the social processes might act as a filter for economic information and that funding outcomes reflect a social as well as an economic process. The contextual approach, put forward by Sargent and Young (1991), acknowledges the fact that raising finance is a complex and dynamic process and may be affected by a number of different factors, both economic and social. Perceptions of the entrepreneur, also, play a major role. Also, how both lender and borrower perceive each other will ultimately shape the financing relationship. The financing relationship therefore incorporates a level of social interaction based on the expectations and interpretations of both parties involved. Such an approach recognises that entrepreneurs with different occupational, social, and educational experiences may well follow different approaches to enterprise financing, which may result in different problems, and different business outcomes (Read 1998).

Also within the same line, North (1995) considers that individuals may choose more costly transactions, if they possess different mental models to interpret the world around them. He argues that not only the rationality postulate prevents the actors from achieving the joint maximisation result, but also the specific characteristics of transacting. Hence, the intergenerational transfer of knowledge, values, and norms that vary radically among the different groups and societies, in part culturally derived, produce these mental models. In part they are acquired through experience, which is local to the particular environment and therefore also vary widely with the different environments. He also mentions that there is an immense variation in mental models, and as a result there are different perceptions of the world and the way it works. These mental models are those which the policy makers and development economists fail to take into consideration while formulating their polices (North 1995).

This contrast with the traditional economic and financial assumption, which emphasises rationality and profit maximisation as the primary basis for financing, was observed since the early 1960's by several researchers such as Miller, as mentioned earlier, who suggests that the results do not always correspond to theory and that enterprises fall into some financing patterns or habits, which have no relevance to enterprise value. The habits may make managers feel better, and since they are harmless, no one cares to stop or change them. Also as mentioned in Bolton's report that running an own enterprise and working for oneself has psychological satisfactions that appeared to be much more powerful in motivation than money or the possibility of making large profits (Cosh and Hughes 1994).

It could be easily noticed from the review presented in this section that the enterprise owners' characteristics influence the financial behaviour. These include the characteristics of the enterprise and their external relationships, and the nature of the input and output linkages found among the various economic agents, producers, traders and consumers, besides the financial factors. Hence, any finance model developed should take into account the non-economic elements.

2.4 Informal finance

Informal finance and its role in the development process has been of increasing importance, and controversial, for economists and policy makers in recent years. Until the early 1980's, most of the research was focused on the formal finance, which is that portion of the financial system that is regulated by a central monetary authority, and only occasional mention was made of the financial activities that were not regulated, the informal finance markets. The research on the informal finance was mainly undertaken in what was colonial India, by sociologists and anthropologists (Adams and Fitchett 1992). Little or no attention has been paid to the potential development role of the informal financial markets or the significant role it plays in financing MSEs. Informal finance was, and often still is, identified as a money market which is dominated by dishonest moneylenders, traders and landlords who were commonly regarded as being anything but development oriented (Bouman 1994).

Furthermore, the assumption in a number of researches and studies that the lack of access to formal credit market has forced MSEs to look for informal sources of funds resulted in validating the performance of informal financial markets in supplying credit to the micro and small enterprises (Lapar 1991; Montiel et al. 1993; Chaudhuri and Gupta 1996). Furthermore, the activities of the informal finance were considered relatively marginal and confined to social matters. e.g. meeting the costs of funerals. Such misunderstanding of the nature and role of informal finance, the alleged inaccessibility of this sector to the researchers and the almost complete absence of statistics and basic data on what is going on in the informal finance market explain the scarcity of research studies of the informal finance sector. The studies into informal finance are lagging much behind the present lively interest in other areas of the so-called informal sector (Bouman and Hospes 1994). Hence, there is little information, especially of a detailed quantitative nature, available on the size of informal financial markets in developing countries or on the transactions that take place in these markets.

Nevertheless, several economic and sociological studies have shown the importance of this sector in terms of both the number of the participants and the volume of funds. In low-income countries, the informal financial services amounts that circulate are often as large as those which go through the banking sectors. Informal lenders are able to be more creative in coming up with loan contracts that allow for collateral substitutes in the absence of fixed collateral (Adams and Fitchett 1992). Informal finance is not just confined to low-income countries as indicated by several surveys. For example the Cambridge survey in the UK, revealed that informal finance was most significant amongst microenterprises (Cosh and Hughes 1994).

Research into informal finance markets can be divided into two distinct schools of thought. The first school of thought views the informal financial markets as a consequence of the government's policy distortions, and emphasises the negative consequence of the financial dualism. It views informal financial markets as fragmented and dominated by usurious moneylenders who play a negative role in the economic development, and should be absorbed into the formal sector during the financial development process (Fry 1995; Steel et al. 1997). This school of thought, which is articulated in the writings done by Mckinnon and Shaw in Fry (1995), claim that financial repression and high access costs in the formal finance are among the main reasons for the existence, and the large size of, informal financial markets. The informal financial markets typically found in low-income countries have been exemplified by this school and traditionally has been excluded from the analysis models. Despite this, the neo-structuralists, who also belong to the same school of thought, recognise the importance of the informal credit markets. However, the notion of informality embedded in their view of the informal financial markets is unfortunately restrictive (Srivastava 1998). This school of thought helped to sustain a belief in the moral and technical superiority of the formal finance markets. Informal finance sources such as informal lenders and traders are not considered, since the focus is primarily on formal sources of credit such as government and NGO run programmes. Therefore, most of the recommendations coming from this school resulted in efforts being put into considering legislative and other means of eliminating the informal activity rather than into understanding the growth and the implications of the existence of these markets.

The second school of thought, or the opposing view, claims that informal financial markets maintain very low transaction costs because of their comparative advantage in information acquisition and low administration cost. This school suggests that informal financial markets should be protected from government intervention and regulation. They strongly criticise the previously mentioned opinions about the informal financial sector and suggest that the first school's opinions are based on work done by people who do not participate in these markets, and are based on incomplete information and a bias against informal finance activity (Adams and Fitchett 1992; Bouman and Hospes 1994). This school claims that regarding informal financial markets as a response to failure in formal finance confuses the chronological facts that informal financial markets preceded the formal financial markets by tens of centuries. Informal credit sources are usually tapped for microenterprise start-ups and in providing working capital (Seibel 1997; Von-Pischke 1997). Recent research has revealed that informal financial markets tailor their financial services, both savings and credit, to many clients who are defined not creditworthy by commercial banks, to meet the requirements of their low-income borrowers and savers. Therefore, the recommendation coming from this school of thought concludes that informal institutions should not be viewed as a substitute for the formal institutions as has been done in the past, but they should be viewed as complements (Floro and Yotopoulos 1991; Steel et al. 1997).

It has been argued that the two different schools of thoughts resulted from the disagreement about what is meant by the informal finance. Treating the informal financial activity as a residual is partly responsible for the lack of in-depth analysis in the financial development literature (Mohieldin and Wright 2000). There are a large number of empirical studies of informal intermediaries. However, no attempt has been made yet to formally explain the coexistence of formal and informal finance in urban areas in most of the developing countries, and on how they interact with each other. With a few exceptions, attention has been paid exclusively to rural credit and agricultural credit in particular as discussed in section 2.2. It is worth mentioning that one of the unique features of the informal finance sector is that it enhances trust by making existing ties an integral component in the relationship between the transacting parties. Also, the informal finance sector has very low transaction costs because business is conducted face-to-face, with little documentation, quickly, and between people who know each other.

2.5 Summary and conclusions

This chapter attempted to utilise theories derived from divergent disciplines. The literature review of the historical development of the microenterprise finance concept revealed that the increase in the supply of loans by governments and development assistance agencies has not been accompanied by a parallel evaluation of the real demand of finance among MSEs. This scarcity of studies is mainly due to the widely held belief that the economic activity can be created by supply-leading finance provided in advance of effective demand for financial services and the discussed misconception about the informal finance markets.

This chapter also highlighted the fact that research in microenterprise financing can be characterised by the lack of a theoretical framework. There are a lot of empirically based studies, but very few studies try to put the results into a broader theoretical framework. The studies for assessing the true determinants of the finance demand for microenterprise were not available. In contrast, there is a huge literature on the small enterprise finance, rural credit and microfinance as a poverty alleviation tool. The majority of the literature on the determinant of the enterprise finance mainly emerged from research in advanced industrialised countries; hence they are more relevant to their conditions rather than to developing countries. Most of the theories of finance assume the existence of well-developed capital markets. Therefore, they are mainly concerned with advanced economies. In less developed countries, however, financial markets are generally underdeveloped. Financial markets are immature and therefore are less efficient. An enterprise's decision on the use of different sources of finance may be influenced by factors other than those usually typified as information asymmetry or transaction costs. Furthermore, existing capital structure theories do not include factors such as owners' objectives and characteristics, which are relevant to the financing decisions. Nevertheless, the POH discussed in this chapter may provide an explanation for the demand preference of the enterprises' owners, which will be further examined in chapter six.

Much less, if any, attention was paid to the behaviour and peculiarities of microenterprises' owners in terms of formulating the finance needs, despite the fact that entrepreneurial characteristics, prior experiences and business goals influence financing decisions, as well as the business life-cycle issues. There is a huge gap in the understanding of the behavioural and cultural role in the financial decision. Researchers mostly try to analyse and describe the enterprise's financial preferences without taking into consideration a major assumption of the preferences of the owner/manager, which lead to an imperfect model. Furthermore, most of the models developed have not incorporated into their assumptions the scale of the informal finance.

In conclusion, the preceding review of literature has highlighted major gaps in research on micro and small enterprise finance. In this study an attempt to go beyond a mere descriptive research and to investigate qualitatively beyond the financial structure itself is made in order to address the issues of financial constraints more directly. The two main research questions raised from this literature review will be answered. The first research question is: Is there a relation between the growth of microenterprises in urban Egypt and the different forms of formal and informal finance? Where, the existing research on MSEs has not isolated the importance of the different forms of finance. The second research question is: Is the primary explanation for urban microenterprises' lack of use of formal finance due to the personal characteristics specific to the microenterprises' owners, or is the explanation more general in nature? It cannot be denied that a considerable amount is known about the behaviour of smaller enterprises in a range of areas relating to growth, employment, efficiency, investment and management. However, despite this acknowledgment, the key determinants of capital structures of MSEs do not appear much clearer today; researchers are unable to explain satisfactorily how microenterprise owners choose between different types of finance.

Hence this study will contribute to filling in the gap identified in the literature by highlighting the different roles that finance play, with special emphasis on the informal finance sector's role and the microenterprise's characteristics that directly affect the financing choice.

Chapter Three: The Environment for Microenterprise Finance in Egypt

3.1 Introduction

The issue of micro and small enterprises ranks high among the Egyptian government priorities for socio-economic development since the beginning of the 1990's. Given the growing need for employment creation, to which MSEs can make a major contribution, MSEs' development has become a focus of attention of the government; therefore, it has established a ministerial committee for microcredit in 2001, and a nation wide program of financial deepening targeting specifically the MSE sector. The study of microenterprise finance in Egypt is significant, because microenterprise finance programs attract a large chunk of the limited development budget sources; i.e. more than 500 million Egyptian pounds a year for the 2001-2006 period have been pledged for the main government microcredit programme, the Social Fund for Development. Hence, this chapter will provide a profile of the extent, nature, and growth of microenterprise finance in Egypt. Such a descriptive overview and practical critique, based on the author's personal experience in working with the Consultative Group to Assist the Poorest (CGAP), can usefully serve to provide a foundation for understanding the overall magnitude, the role played by microenterprises, and why the study of urban microenterprise finance is important.

This chapter discusses firstly, the socio-economic situation in Egypt. Secondly, it discusses the microenterprises' definition, role, and importance in the Egyptian economy. Thirdly, it discusses the existing or the available finance sources for microenterprises in Egypt. Fourthly, it discusses the history and the present landscape of microenterprise finance models in Egypt. Fifthly, it discusses the current research and the literature available on microenterprise finance in Egypt, in addition to highlighting the gaps in such work. Finally, the chapter ends up with a summary and conclusions.

3.2 Socio-economic situation in Egypt

3.2.1 Current economic situation in Egypt

Egypt has been following a liberal economic policy since 1974. The past five decades have witnessed dramatic shifts in development orientation in Egypt from an inward looking, import substitution development strategy with a state controlled economy in the 1950's and 1960's, to an open door policy in 1974. Serious attempts at the implementation of the structural adjustments policy started in the first half of the nineties, when the government of Egypt adopted an Economic Reform and Structural Adjustments Program (ERSAP) to stabilise the economy and to restore growth. A major consequence of the structural adjustment policies has been economic stagflation; i.e., both inflation and recession at the same time. Inflation was mainly due to the attempt to bring national prices to the level of international prices, the abolition of protective policies towards national industries, lifting of subsidies, and the devaluing of the Egyptian currency by almost 25 percent during 2001. Recession was due to the deflationary policies followed by the government, the reduction of the money supply, and the decline in government expenditures to decrease the deficit in the national budget.

Despite the fact that the market mechanism is used to determine the goods' and services' prices according to supply and demand, wages and salaries are controlled, especially in the government and the large public sector, and increases at a much slower rate than the increase in prices. The government also started curtailing the policy of guaranteed employment of college and high school graduates, which led to the high increase in unemployment rates. This high unemployment can be attributed mainly to previous government policies that favoured capital-intensive production since the early 1960s. The non-labour intensive nature of the economic growth has thus contributed to the serious unemployment problem facing Egypt. Among the Egyptians, 50 percent are employed in the formal sector. The formal sector is no longer able to provide employment for the majority of people seeking employment. The labour absorption capacity of the formal sector in urban areas has declined rapidly. The official estimates of unemployment rate are about 10 percent, and the unofficial unemployment rate is at around 20 percent (Dhumale et al. 1999). Over 93 percent of the unemployed, as of 1995, are less than 30 years old, and most of them are college and high school graduates (Assaad and Rouchdy 1998). The growth in employment in Egypt has constantly lagged behind the economic growth. The figures for the 1998 fiscal year indicate that real inflation averaged 6.2 percent and GDP grew by 5.3 percent (Institute of National Planning 1998); this GDP growth figure has dropped dramatically during the last two years due to the previously discussed economic situation, which shows that the increase in the GDP for 2001 is between 1-2 percent only. An annual GDP expansion of 7-8 percent is the minimum target, if Egypt wants to create the 450,000 new jobs it requires each year and to prevent unemployment rising even higher (Osman 1998; Dhumale et al. 1999). Hence, the Egyptian government started looking at the MSEs to fill this role in reducing unemployment and narrowing the income gap between different groups.

3.2.2 Income gap between the urban and the rural population in Egypt

Egypt's population of more than 70,712,345 as of July 2002 (estimated) and continues to grow at the rate of 1.6 percent per year (CIA 2002). Over 99 percent of the population live in the narrow strip of the Nile valley, which runs the length of the country, and in the Nile Delta. The service sector dominates the Egyptian economy, including public administration, which accounts for half of the GDP. Within this sector, tourism and the Suez Canal are very important sources of income. Agriculture remains an important economic activity, even though less than 3 percent of Egypt's area is arable land; 32 percent of the population earn their living from agriculture. Most crops are for local consumption but cotton is a major export. Industry accounts for approximately 17 percent of the GDP, and is heavily concentrated in Cairo and the Nile Delta. Petroleum and natural gas are the mainstays of the economy, accounting for around 10 percent of the GDP (The Economist Intelligence Unit 2000).

With respect to illiteracy, the population statistics in Egypt indicate that about 33 percent of the population are illiterate (Assaad and Rouchdy 1998). As mentioned by Osman (1998), using a consumption/expenditure based analysis the estimated poverty measures, as estimated from a headcount index, reached 22.9 percent as of 1995/6, as shown in table 3.1.

Table 3.1: Poverty groups (%), 1995/96.

Poverty Groups	**Egypt**	**Rural**	**Urban**
Poor, of which:	22.9	23.3	22.5
(Ultra poor)	(7.4)	(7.1)	(7.7)
Moderately Poor	25.1	26.9	22.5
Non-Poor	52.0	49.8	55.0

Source: Osman (1998) page 5.

At the national level, the prevalence of poverty does not vary significantly between rural and urban areas, as shown by the above table, yet most studies focused on rural finance rather than urban finance in Egypt, and the government microfinance programs in the 1970's and the 1980's were mainly targeting at rural areas in Egypt. This small difference in poverty distribution does not justify the concentration of finance studies on rural areas. Furthermore, as will be discussed in section 3.6, the studies investigating the true needs of urban microenterprise are lagging behind rural studies. Furthermore, unemployment is concentrated in urban areas, particularly amongst new graduates (Crump 1996).

3.3 Microenterprises in Egypt

3.3.1 Definition

In Egypt, as in most countries, there is no unique and binding definition of a microenterprise. The only existing definitions of this sector are the ones that have been developed by single institutions. These definitions can hardly be assimilated or compared. Moreover, they have not received acceptance by the Egyptian authorities. The microenterprise definitions in Egypt are characterised by a very high diversity among the responsible authorities, the different promotion programs (donors), and the academic researchers; i.e. there are no uniform criteria by which microenterprises can be defined.

The authorities define microenterprises as rather large compared with the international organisations operating in Egypt. They hardly consider enterprises employing less than 10 workers. For example, the General Authority for Manufacturing defines microenterprises as those enterprises that have fixed assets of less than 500,000 Egyptian pounds, and small enterprises as those who have fixed assets of less than 1,000,000 Egyptian pounds. The Industrial Development Bank defines microenterprises as those with assets, not including land and building, less than 100,000 Egyptian pounds, very small enterprises with assets less than 700,000 Egyptian pounds, and small enterprises with total assets of 1,400,000 Egyptian pounds (Bassal 1998). The Ministry of Planning defines microenterprises as those employing less than 25 employees, with fixed assets less than 50.000 Egyptian pounds, and machinery of less than 10 horsepower. In general, the microenterprise, in the government's view, is considered as the artisan sector; those are enterprises with 1 to 9 workers and less than 8,000 Egyptian pounds of fixed assets (Abd El-Mageed 1998). Hence, it is clear that among the different Egyptian government authorities there is no clear and uniform working definition for microenterprises and they do not include the informal sector in their definitions.

On the other hand, definitions used by aid donors differ, and this further confuses the picture. The United States Agency for International Development (USAID), which is the major fund donor in Egypt, and the Danish International Development Agency (DANIDA) define microenterprises as enterprises having 1 to 5 employees, and small enterprises as having 6 to 15 employees with less than 25,000 Egyptian pounds in fixed assets, excluding lands and building. The various USAID supported associations running loan programs follow that definition, such as the Egyptian Small Enterprises Development Association (ESEDA), the micro and small enterprise project of the Alexandria Business Association (ABA), and National Bank for Development (NBD) (Abd El-Mageed 1998). On the other hand, the formal definition used by the World Bank defines microenterprises as enterprises that have fewer than 10 employees and small enterprises as enterprises that have 10 to 50 employees (Brandsma and Chaouali 1998).

Furthermore, even among academic researchers it is difficult to find a unified definition, e.g. in the study by Baydas et al (1997b), they define a microenterprise as an enterprise with 1-9 employees, and a small enterprise as an enterprise with 10-49 employees; where in a study by El-Mahdi et al. (1999) the microenterprise is defined as an enterprise with 1-5 employees.

As seen from the above discussion, the authorities/policymakers, donors, and academic researchers often use conflicting terminology when defining microenterprises relative to small enterprises. The definitions of microenterprises are not consistent. However, there is a general consensus about micro and small enterprises which is that they are labour intensive (El-Mahdi 1995; Baydas et al. 1997b; Abd-El-Mageed 1998; Ministry of Economy 1998; El-Mahdi et al. 1999), thereby making these enterprises quite suitable for developing countries with large populations. In practice, there is a large crossover and correlation between micro and small enterprises and the informal sector. Hence, for the purpose of this thesis, as mentioned in chapter one, microenterprises are defined as enterprises employing five workers or less, small enterprises are defined as enterprises employing six to fourteen workers, and medium enterprises are defined as enterprises employing fifteen to forty nine workers.

3.3.2 Microenterprises' role in the Egyptian economy

Recent statistics show that microenterprises play a significant role in the economic and social development of Egypt. Egypt's microenterprises numerically dominate the private sector with 92.6 percent of the private economic non-agriculture enterprises units employing less than five workers, according to the latest census undertaken by the Central Agency for Public Mobilisation and Statistics (CAPMAS) in 1996, which includes the formal and informal sector. This is shown in table 3.2.

The analysis of the employment structure of MSEs in private non-agricultural economic activities, as shown in table 3.3, indicates that 73 percent of the total labour force is engaged in activities classified as MSEs, of which 71 percent are employed by the microenterprise sector. Therefore, this sector according to table 3.3, employs the majority of Egypt's private workforce, around 3 million employees. Other studies estimated that this figure is even much higher if members of the workforce under the age of 12 are considered (El-Mahdi 1995). According to a 1994 labour force sample survey, those who were privately employed outside formal establishments, including microenterprises, constituted 60 percent of the total workforce (15-64 years old) in urban areas (Huband 2001).

In addition to the significant importance of this sector, which is revealed by tables 3.2 and 3.3, those two tables also reveal a major characteristic of this sector, which is the heterogeneity of the economic activities. Major employment in this sector is in trading activities (1.5 million), manufacturing/workshops (0.5 million) and in services (0.25 million).

It is also important to note that this sector is not necessarily dominated by the society's poor or the underprivileged (El-Mahdi 1995; Hulme 2000). Microenterprises are not poverty stricken enterprises, but nevertheless their businesses are very small that they could not offer collateral or be accepted among the mainstream of the formal credit market, as discussed in chapter one.

Table 3.2: Distribution of MSEs in private non-agricultural economic activities.

Sub-sector	Micro No.	%*	Small No.	%*	Medium No.	%*	Total No. Of MSEs	% of Entire MSE Sector	Total Private Sector Units No.	MSE as % of Private Sector Units♣
1. Fishing	479	91.7	29	5.5	14	2.7	522	0.03	522	100.0
2. Petroleum, mining & quarrying	185	31.0	297	50.0	114	19.0	596	0.03	669	89.8
3. Manufacture	233480	84.0	38754	14.0	5454	2.0	277688	16.80	279922	99.2
4. Electricity, Gas & Water	304	35.0	296	34.0	269	31.0	869	0.05	983	88.4
5. Construction	8619	74.0	2321	20.0	673	6.0	11613	0.70	11961	98.0
6. Wholesale & Retail Trade, and Vehicle maintenance	963147	96.3	33943	3.4	3054	0.3	1000144	60.60	1000792	99.9
7. Hotels and Restaurants	76237	90.7	7066	8.4	723	0.8	84026	5.10	84261	99.7
8. Transportation, Storage and communication.	36120	88.6	3830	9.4	818	2.0	40768	2.40	41040	99.3
9. Financial Intermediation	1644	34.4	1820	38.3	1309	27.3	4773	0.30	5113	93.3
10.Real estate, Renting & business services	49010	91.6	3984	7.4	506	1.0	53500	3.20	53626	99.7
11.Education	4510	68.6	1267	19.2	797	12.1	6574	0.40	6871	95.6
12.Health and Social work	46646	90.7	4071	7.9	696	1.4	51413	3.10	51553	99.7
13.Community, Social and personal services	112172	96.7	3369	2.9	479	0.4	116020	7.00	116122	99.9
14.Regional and International organisations and embassies	58	17.3	192	57.0	86	25.5	336	0.02	343	98.0
15.Unspecified	878	92.2	50	5.2	24	2.5	952	0.05	956	99.6
Total	1533489	92.6	101289	6.1	15016	0.9	1649794	100.00	1654734	99.7

Notes:

1. The Technical Office of the Minister of Economy based on CAPMAS 1996 Establishments Census prepared the table.
2. The table excludes economic units active in agriculture.

* Denotes the share of this category (micro, small or medium) of the total number of MSEs in the sub-sector (fishing, manufacture, etc.).

♣ Microenterprises (1-4 workers) represent 92.6 percent of private sector; small enterprises (5-14 workers) represent 6.12 percent of private sector; medium enterprises (15-49 workers); represent 0.9 percent of private sector.

Source: Ministry of Economy (1998).

Table 3.3: Distribution of employment of MSEs in private non-agricultural economic activities.

Sub-sector	Micro No.	%*	Small No.	%*	Medium No.	%*	Total Employment No.	MSE % of Entire MSE Sector	Total Private Sector Employment No.	MSE Employment as % of Private Sector emp.♣
1. Fishing	959	64.1	233	15.6	303	20.3	1495	0.04	1495	100.0
2. Petroleum, mining, & quarrying	473	8.1	2363	40.3	3027	51.6	5863	0.16	25179	23.2
3. Manufacture	486489	54.8	266832	30.0	133704	15.0	887025	24.47	1716392	51.7
4. Electricity, Gas & Water	675	7.2	2365	25.1	6397	67.7	9437	0.26	35532	26.4
5. Construction	17216	33.3	17400	33.7	17010	33.0	51626	1.40	127637	40.4
6. Wholesale & Retail Trade, and Vehicle maintenance	1479967	83.3	222900	12.6	72171	4.1	1775038	49.00	1893716	93.7
7. Hotels and Restaurants	152803	70.5	46587	21.4	17620	8.1	217010	6.00	257356	84.3
8. Transportation, Storage and communication.	55366	53.8	27827	27.1	19593	19.1	102788	2.80	154837	66.3
9. Financial Intermediation	3503	6.9	15911	31.3	31434	61.8	50848	1.40	105886	48.0
10.Real estate, Renting & business services	94880	70.7	27026	20.1	12266	9.2	134172	3.70	155791	86.1
11.Education	8714	22.0	9517	24.0	21384	54.0	39615	1.10	70725	56.0
12.Health and Social work	97423	68.3	29352	20.6	15859	11.1	142634	4.00	160949	88.6
13.Community, Social and personal services	167035	83.1	23436	11.6	10566	5.3	201027	5.60	217364	92.4
14.Regional and International organisations and embassies	135	3.6	1674	45.2	1900	51.2	3709	0.16	4325	85.7
15.Unspecified	1321	59.6	344	15.5	551	24.9	2216	0.60	2559	86.6
	2566968	70.8	693769	19.2	363775	10.0	3624512	100.00	4929740	73.5

Notes:

1. The Technical Office of the Minister of Economy based on CAPMAS 1996 Establishments Census prepared the table.
2. The table excludes economic units active in agriculture.

* Denotes the share of this category (micro, small or medium) of the total number of MSEs employees in the sub-sector (fishing, manufacture, etc).

♣ Microenterprises (1-4 workers) represent 52 percent of private sector employment; small enterprises (5-14 workers) represent 14 percent of private sector employment; medium enterprises (15-49 Workers) represent 7.4 percent of private sector employment.

Source: (Ministry of Economy 1998).

Despite the significance of this sector, as shown above, the microenterprise sector has not been subject to much attention from the government until the last ten years. This was mainly because the authorities view many MSEs as an informal sector, not registered under an act made official by a legislative body, and the production of these enterprises is not geared at all for export, but rather for the low end domestic consumption, cheap, and low-quality goods. These beliefs are contradicted by a growing body of research, which showed that around 30 percent of Egypt's GDP is generated by non-agricultural small producers in the informal sector (Huband 2001). Nevertheless, in the last ten years this section started to be viewed as a major absorber of labour and a provider of a wide range of goods, as will be discussed later in section 3.6 with regard to the research work on Egypt. Despite this recent recognition and attention by the government, the capital-intensive projects still receive more encouragement from the government, e.g. through the tax holiday and the proper presentation in the hierarchy of government power. Furthermore, microenterprises do not have proper access to the formal financial system as will be discussed in the next section.

3.4 Egypt's financial system

The Egyptian financial system consists of financial intermediaries with varying degrees of supervision and regulation by the government agencies. This spectrum consists of entities ranging from those subject to very close supervision and regulation, such as banks, to the informal financial sector, which is totally unregulated and unsupervised. There are also entities that are not under the regulation of the Central Bank but are registered with other government agencies, such as the non-government organisations (NGOs) engaged in lending, which are registered and supervised by the Ministry of Social Affairs. A strict classification is not always possible; although in classifying the financial system in Egypt the classification suggested by Seibel (1996) will be followed, which consists largely of formal, semi-formal, and informal finance. This classification identifies those institutions that are officially registered but are not subject to banking supervision and regulation, such as NGOs and co-operatives, which are termed semi-formal.

3.4.1 The formal financial sector

Formal finance institutions are here defined as those financial institutions that are authorised and supervised by government organisations such as commercial and industrial banks. The Egyptian government plays a major role in Egypt's financial sector where the Central Bank of Egypt controls the banking system and directs monetary, credit, and general banking policies through the usual means of discount and interest rates, liquidity, and reserve ratios. All of the Egyptian banks were nationalised in 1961, and by 1963 the banking system contained only five public sector banks and some specialised banks. As of the 31st of March 1999, Egypt's banking system included 28 commercial banks: 4 of which are state-owned, and 24 are private and joint venture banks; the total number of branches is 2,428 as shown in table 3.4. The four government-owned commercial banks, the National Bank of Egypt, the Bank of Alexandria, the Banque du Caire, and the Banque Misr, dominate the sector due to their size in terms of assets, deposit base, and branches accounting for 62 percent of the banking system's total assets. Also, among the major banks that offer loans to the microenterprises is the Principal Bank for Development and Agricultural Credit (PBDAC). In addition to the banking system, there is the saving system of the post office that has more than 2,900 outlets, which are widely used in rural areas.

Table 3.4: The Egyptian banking system as on 31/3/1999.

Type	Ownership		Number of
Commercial banks	4	Public banks	914
	24	Private and joint venture banks	321
Business and investment banks	11	Private and joint venture banks	103
	20	Off shore banks	44
Specialised banks	1	Industrial Development Bank	14
	2	Real estate banks	25
	1	Principal Bank for Development and Agricultural Credit	1007
Total	63	Banks	2428

Egyptian banks abroad are not included; also two banks established under private laws are not registered with Central Bank of Egypt: the Arab International Bank and Nasser Social Bank.
Source: Central Bank of Egypt (1999). First Quarter Economic Review page 102.

Despite this high outreach capacity of the collective loan portfolio of the banking sector in Egypt, the loan portfolio of micro, small, and medium enterprises does not exceed 6 percent of the total loans portfolio as indicated by a study undertaken by the World Bank in 1995 (Baydas et al. 1997b; Ministry of Economy 1998). The formal financial institutions ration out a substantial number of borrowers, particularly the MSEs. Such rationing results mainly because of their corporate culture where the entry of foreign banks into the domestic market is restricted and the four major banks dominate the market. Therefore they do not see themselves as financial intermediaries competing with each other in a market to identify new opportunities to earn higher yields with less risk for their depositors and shareholders (Baydas et al. 1997b). The public commercial banks do not appear to be progressive in offering modern services. Their corporate culture is based on a vision of themselves as government employees following government rules regarding accepting deposits and making loans. Furthermore, the high cost structure of the formal sector does not motivate it to make small sized loans required by MSEs besides the difficulty in determining the creditworthiness of these borrowers, where the majority of microenterprises are unable to put up the required collateral to prove their creditworthiness. Currently the public banks, which dominate this sector, are undergoing restructure programs and are encouraged to be more profitable; therefore, they will be reluctant to enter into the new microenterprise finance market (Garson 1997). Thus commercial banks participating in microenterprise financing will not increase; they may decrease to less than 6 percent in spite of all of the government's rhetoric about microenterprise development.

3.4.2 The semi-formal financial sector

Semi-formal finance is provided by entities that operate under government charter, or special charter, and transact financial contracts with little or no government supervision. This includes Non-Governmental Organisations (NGOs) which are under the supervision of the Ministry of Social Affairs (MoSA); and the Social Fund for Development (SFD), which is a governmental program established in 1991 to alleviate problems resulting from implementing Egypt's economic reform and structural adjustment program. The Semi-formal financial sector represents an alternative model to the commercial bank lending to MSEs. They have different legal forms and are supported by a number of donor organisations as will be discussed in further details in section 3.5.

3.4.3 The informal financial sector

Informal finance is very popular in Egypt, where the most recent research indicates that a majority of Egyptians, in all walks of life, use such finance. For example, a recent research in a large agriculture bank in Egypt showed that many of its employees participated in informal finance. Even in villages with bank branches, villagers also showed extensive involvement in the informal finance (Baydas et al. 1995; Von-Pischke 1997).

Informal finance sources encompass all other financial lending and deposits taking that occur outside the government authorisation or supervision; they include all others such as Rotating Savings and Credit Associations (RoSCAs), which is known as the *Gam'iya*, trade credit, supplier advances, family and friends, local moneylenders, etc. It is extremely difficult to assess the overall size of the informal finance markets in urban and rural areas. Informal intermediaries hardly disclose their detailed customers or portfolio data. The following sections define in details the major forms of informal finance in Egypt.

3.4.3.1 Gam'iya

Gam'iya is the Egyptian name of the self-help groups, which are popular in many developing countries and are generally referred to in the literature as Rotating Savings and Credit Association (RoSCA). The Arabic translation of this word means cooperativeness or team up. This practice existed many years ago and is still very common today among the different levels of the Egyptian society.

A RoSCA or *Gam'iya* operates exclusively by its members without any kind of outside intervention. In many respects they even circumvent laws and regulations that apply to other types of financial institutions such restrictions regarding the acceptance of deposits. All types of *Gam'iya* consist of the same set-up; a leader takes the responsibility to organise the *Gam'iya* and is liable for late or non-payment of the individual share members. In a RoSCA, a group of participants put contributions into a group fund that is given to a single member. This is repeated over time until each member has had a turn, by an order determined by a list or lottery. Members regularly pay into the group fund or pot, usually by giving their share to the group leader or during group meetings, which, according to the group decision, can take place daily, every five or ten days, fortnightly or monthly. The number of payments in each cycle depends on the number of shares in each *Gam'iya*. Some members hold two or even more shares. Usually, the *Gam'iya*'s leader is eligible to receive the first pot. This compensates him for his efforts to organise the *Gam'iya* and for assuming the default risk of ordinary group members.

A *Gam'iya* offers a useful financial service that takes a middle position between savings and credit; since the group leader is the first share member to receive the fund, he is a net borrower. The last person in the cycle is a net saver. All other members hold a unique financial position between saving and credit, which is determined by their individual position in the share cycle. *Gam'iya's* members stress the value of quickly accessing funds when the need arises. The size of the group and the contribution of each member may vary. Women usually make up the majority in these groups.

Gam'iya is a significant social and economic phenomena in Egypt, as it is widespread and popular at all levels of the society, even among white-collar workers in large cities, as indicated by a study undertaken by Baydas et al. (1995) on employees of a national bank. It was discovered that 4 out of 5 employees of this bank were members of a *Gam'iya*. It is also used by a lot of businessmen and the value of a *Gam'iya* could range from a 100 Egyptian pounds up to 200,000 Egyptian pounds when done between merchants, as will be shown in chapter five's case studies. The vast majority of the Egyptians join a RoSCA out of compassion to help someone, or more importantly, because they feel membership will force them to save more than they would do otherwise. Also, low transaction costs, flexibility, and building reciprocal obligations are advantages of being involved in finance through RoSCAs (Adams and Ghate 1992).

3.4.3.2 Relatives, friends and neighbours

Loans from relatives, friends and neighbours are perhaps the most common form of informal finance, and are usually the first sources of seeking for finance. These arrangements are characterised by uncollateralised loans that carry no or little interest, open-ended repayment arrangements, and have a strong focus on reciprocity. Relatives, friends and neighbours lend each other at a negotiated rate depending on social relationships and reputation.

Friends and family members financing is a major component of the microenterprise finance sources especially at the early stages of the microenterprise life cycle, where at a later stage, other sources of finance, e.g. commercial banks, seem to become more available.

3.4.3.3 Trade credit and supplier credit

Trade credit is another common source of informal finance. Many traders obtain goods on credit from dealers, and do not pay them until several weeks later. Those loans were always labelled as interest-free, but people who pay cash are given discount. There are usually strong loyalties between a supplier and a client, for example, several studies in Egypt found that some enterprise owners refuse a formal loan even though they would be better off financially with it; the main reason was to keep their relation with their supplier (Baydas et al. 1995; Dichter 1997). The costs of lending are born by the supplier as part of the total cost structure of his business. It will be impossible here to account for the variety of trading finance transactions of microenterprises that can be observed in urban Egypt, but among the most common transactions often used is advancing inputs to microenterprises. Traders' credit plays a role on both the input and the output sides of small enterprises; they either provide necessary inputs to microenterprises on credit, or pre-finance the marketing of their output. Also the hire purchase dealer that penetrates the urban areas is another form of trade credit transactions. In hire purchase dealings, borrowers pay for the good in regular instalments while using it.

3.4.3.4 Money-keepers

Money-keepers, as mentioned by Baydas et al. (1995) and Dichter (1997), are trusted individuals, often with religious backgrounds, who hold deposits without interest. They are significant in rural areas and in high-density urban areas where the poor live. A recent study in Egypt showed that 7 percent of the households surveyed are using money-keepers (Dichter 1997).

3.4.3.5 Others

There are several other important forms of finance, which are not as common as the previously mentioned forms that play a role in financing the microenterprise sector. Among these are:

- Remittances from migrant workers, especially from the Gulf area, play a major role in the informal finance sector. Egypt has more than four million Egyptians working abroad and their annual transfers are more than 10 billion Egyptian pounds; most of this amount is channelled outside the formal finance sector.
- Partnership or *Musharakah* is an informal partnership in which the provider of capital holds an equity position in the enterprise.
- Goldsmith shops usually act as pawnshops, where they can give money in exchange of gold. This is a very common practice in urban and rural areas.
- Moneylenders exist on a very small scale in both rural and urban communities, although they do not advertise that they charge interest. Moneylenders are usually individuals whom lending money might be their main occupation or merely to derive a side income. Moneylenders generally operate in a limited area; i.e. their local area. Terms and conditions of loans from the moneylenders are very much diversified. In general, no collateral is required and they often operate locally.

It should be noted that most policy makers, planners, and researches persistently ignore the existence of the informal finance market discussed above despite the fact that many segments of the population participate in these informal finance arrangements. People borrow from relatives, friends, neighbours, traders, and even moneylenders. Much of the informal credit does not carry an excessively high rate of interest; sometimes it bears no interest at all and is cheaper than the loans from the formal market. The Egyptian literature, as will be shown in section 3.6, generally recognise the informal finance as insufficient to significantly increase productivity, as the loans obtained are generally smaller (Mohieldin and Wright 2000). Furthermore, they claim that due to the lack of collateral and the lack of knowledge, poor households have to rely on the informal finance sources. Despite such opinions, the formal institutions still have a lot to learn from the informal intermediaries with regard to the close relationship between borrowers and lenders, and the flexibility in order to adapt loan contracts to the individual needs and the possibilities of customers. The informal finance manages to fill the niches not yet covered by the formal finance markets.

3.5 Microenterprise finance landscape in Egypt - financing models

There are several financing models available for financing microenterprises in Egypt; this section discusses them in detail. However, first a brief description of the early dealers in microfinance is given, and a thorough discussion of the various financing models is provided.

3.5.1 Historical roots

Egypt was among the first countries in the Middle East to establish microfinance institutions. The Egyptian banks have a historical role in providing loans for small enterprises. This role started a long time ago. There were distinguished credit policies for some sectors such as the agricultural activities in the 1930's, and the fourth American Point Project with the National bank of Egypt in the 1940's (Siam 1996). The following sub-sections give some of the early attempts to establish specialised microfinance institutions.

3.5.1.1 Mit Gamer Co-operative Bank

This bank was established on the model of the German savings banks in 1963, but with one major difference; its operation was on the basis of profit and loss sharing through which it promoted risk sharing. It had two types of loans, investment loans and non-investment loans. A personal guarantee was the only type of guarantee required. This bank was closed due to political reasons in 1968, but during its years of operation there were no defaults on loans. Furthermore, there were strong social links between the bank and its clients where the bank branches were established. The clients felt that they owned this bank which was also used to provide technical assistance to the new entrepreneurs (Al-Naggar 1981).

3.5.1.2 Principal Bank for Development and Agricultural Credit (PBDAC)

The PBDAC is a state owned agricultural bank which has been the main mechanism for the extension of agricultural loans in Egypt since the 1970's. It is involved in lending for desert land development, distribution of agricultural inputs, and short term lending. Loans were typically made in kind based on credit formulas and were recovered through controls exercised over product markets by the bank (Baydas et al. 1995). In addition, PBDAC is implementing a large micro-credit program specifically targeting women and is funded by the USAID. Recently, the bank has expanded its activities to non-farming businesses and regionally to urban areas, as the rural economy became more diversified today than a decade or two ago. PBDAC currently has more than 1007 village and bank branches.

3.5.1.3 Nasser Social Bank

Later in 1971, the Nasser Social Bank was set up to serve Egypt's low-income groups on an interest free or very low interest basis with a starting capital of 1 million Egyptian pounds. Today it has assets in excess of 1.3 billion Egyptian pounds. The Ministry of Social Affairs supervises Nasser Social Bank, which is the institution that manages a large amount of *Zakah* revenues (Assaad and Rouchdy 1998; Parker 1998).

The bank has two types of loans, loans to permit ownership of various means of production, and interest-free loans for social purposes. It provides loans ranging between 1000 Egyptian pounds and 10,000 Egyptian pounds per project. They are repaid in monthly instalments, over 3 to 5 years at a 6 percent annual fixed interest rate. The bank also supports house building and establishment of new projects at a subsidised interest rate, if the projects yield social returns (Institute of National Planning 1998).

3.5.2 Present landscape of microenterprise finance models in Egypt

In this section a brief picture of the present available lending intuitions is given through identifying and discussing in detail the financing models, and the main actors that play a major role in the provision of financial services to microenterprises in Egypt. In addition, the main obstacles that may affect their sustainability on the long term are also presented.

3.5.2.1 The NGO's model

The NGO financing model represents an alternative model to commercial bank lending, especially in micro and small enterprise lending. The NGO approach to MSE lending has gained prominence worldwide, and has been growing in importance in Egypt through the support of a number of donors; among the major donors is the USAID. USAID/Egypt has disbursed 793,000 loans valued at 4.1 billion Egyptian pounds to more than 325,000 micro and small enterprises during the period from 1992 to 2000. As in many other nations, this NGO model provides much of the finance available to microenterprises in Egypt. Millions of microenterprises and poor households around the world now benefit from this model (Matin et al. 1999). This lending model, which was innovated by the NGOs, is more appealing to the microenterprise sector and fills the gap of the information asymmetry and adverse selection, as NGOs' staff visit clients' premises almost daily, calling upon existing clients, and explaining requirements to potential clients. This model does not require records and complex business plans, or guarantees from their clients.

NGOs provide micro loans to MSEs that lack traditional collateral, business records, or an established credit history. The credit technology used to serve this market falls into two general categories, group and individual. Group lending is where several business owners are mutually responsible for repaying loans, which substitute effectively for conventional guarantees. Group lending decreases the cost of lending because they tap into the existing social capital to shift screening, monitoring, and contract enforcement from the lender to the group. Each group member bears joint liability for the debts of the others, monitor, and insure each other (Adams and Fitchett 1992). Group lending technology is not widely used by NGOs in Egypt, just two programs started to implement a pilot programme to test this technique. The most widely used technique is the individual lending technique.

The individual lending technique is based on the individual's reputation in the community. It is more important than the collateral. NGOs provide loans to the existing economic activities, no matter how small, and start-ups. They extend small and short-term loans primarily for working capital on simplified terms. These small and short-term loans not only test the client's commitment to repay, but also allow the client to see whether or not a loan will, in fact, help the business grow. These loans have weekly, bi-weekly, or monthly equal payments. Later, NGOs provide increased loans based on successful repayment. NGOs charge a higher rate of interest than the market, but from the perspective of borrowers, quick credit is more important than low interest rate; from the perspective of lenders, interest must cover transaction costs and the cost of operating the project (Churchill 1999).

Microcredit NGOs in Egypt are of two types. Those which have been set up expressly for the purpose of lending, such as Alexandria Business Association (ABA), which is considered one of the best practices worldwide (Dichter 1997; Ministry of Economy 1998), and those which have added a credit component to their portfolio of social and development programs, such as those run by CARE, UNICEF, and the Coptic Evangelical Organisation for Social Services (CEOSS). The official number of NGOs registered in Egypt under the Law 32 varies between 13,000 and 15,000; however, about 500 are considered to be active, and only around 45 are truly active in microcredit. The government, in order to implement its social programs, has helped in creating most of these NGOs; they operate under the supervision of the Ministry of Social Affairs (MoSA). They are largely active in urban areas and focus mainly on social development and welfare providing services to approximately 5.5 million beneficiaries. However, because most of them have been created to execute government projects, they lack an independent institutional identity. Many NGOs credit programs do not have the accountability, financial and human resources, and administrative structure necessary to be sustainable on the long term. Furthermore, most of the loans in these credit programmes are given as working capital for existing microenterprises rather than for new start-ups or for fixed asset investment (Assaad and Rouchdy 1998; Barasoum and Shaban 1999).

Among the best practices of the specialised NGOs in Egypt is the Small and Micro Enterprise Project (SMEP) of Alexandria Business Association (ABA). It managed to achieve financial sustainability and has a remarkable loan repayment rate of over 98 percent of disbursements. It is considered to be one of the best microfinance programs in the Middle East. ABA charges a flat rate of interest, calculated on the initial loan amount, set at 4 percent above the average rate charged by the commercial banks on the overdraft accounts; this rate is applied to both micro and small enterprise loans. Overdraft rates vary from 10 percent to 18 percent. If the overdraft rate is 12 percent, a client borrowing 1,000 Egyptian pounds for eight months would have to pay monthly instalments of 180 Egyptian pounds, which results in an effective interest rate of 28.01 percent. This effective interest rate, without taking inflation into consideration, falls below the high rates prevailing in other countries, such as in Colombia 52 percent, in Indonesia 48 percent, and in The Dominican Republic 67 percent. However, it is still higher than the low rates applied in microfinance programs in countries like Bangladesh 12 percent, Niger 18 percent, and Costa Rica 23 percent. In addition, it is definitely higher than the interest rates paid by larger enterprises to commercial banks which range from 14 to 18 percent. Because of the low capital intensity of the microenterprise sector, the rate of return on equity is usually very high and can easily meet these high interest rates, as will be discussed in section 5.5.1. ABA started its microfinance operation by a USAID donated fund deposited in $US interest bearing accounts at several commercial banks. These deposits serve as collateral for overdraft accounts in Egyptian pounds. The SMEP identifies suitable borrowers and disburse loans using checks drawn on these overdraft accounts, and the participating banks provide daily listings of each loan repayment received. Loan sizes are usually between 1000 Egyptian pounds and 15,000 Egyptian pounds. This model is implemented by the USAID through several business associations and co-operatives. ABA is operating in four governorates, and as of December 2000, the project has served over 60,000 clients with about 25,000 active clients. It has extended over 170,000 loans amounting to almost 450 million Egyptian pounds (Dichter 1997; Brandsma and Chaouali 1998). ABA's clients tend to be from the upper end of the microenterprise sector. Almost all of ABA's clients have stalls or shops; they are not usually home based (Churchill 1999). It is worth mentioning that the ABA begins to shift its targeting to trade and services, away from manufacturing; its incentive system for staff creates an incentive to take on the lower risk borrowers who tend to be those less in need (Dichter 1997).

From reviewing the current status of the NGO microcredit programmes, there are two main points that affect the sustainability of such programs over the long run. The first point is the limited finance available to these programs, which comes primarily from government soft loan grants, from commercial banks or donor agencies; therefore, unless they can access commercial sources of finance; i.e. savings and commercial loans, the growth potential of the microfinance formal institutions will be limited. NGOs are not allowed to receive any form of saving or deposits, as according to the Egyptian law, taking deposits outside the formal banking system is prohibited. This is one of the main reasons that hinder the future development of microfinance and lead people to deal with the informal finance markets. Credit without savings can be distorting, and the Egyptian government doesn't seem to adjust this matter due to previous bad experience and regulatory failure. Numerous companies, of which the best known were Al Rayan and Al Sharif, who collected money from small savers, collapsed. They were basically pyramid schemes in which payments to existing customers were made from new deposits. These companies were not regulated by the central bank or by any other authorities (Wilson 1999).

The second point that affects the sustainability of finance supply is that the concept of the cost of money is still ignored by many NGOs, including the largest organisations. Entirely unprofessional and untrained staff manage large credit funds. Most of the NGOs never really had to manage money in the true sense, but are accustomed to channelling money and not managing it (Baydas et al. 1997a; Ministry of Economy 1998).

3.5.2.2 Commercial banks model - the banks' microfinance windows

With rare exceptions, the private sector commercial banks are not interested in financing MSEs in urban areas; this coincides with the same attitudes of the banks in other developing and developed countries. Egypt's commercial banks have traditionally avoided the MSEs sector because of the relative inadequacy of MSEs' collateral and the high transactions costs of lending to this sector. Apart from the

Principal Bank for Development and Agriculture Credit, which mainly provides loans to rural MSEs, the National Bank of Egypt, which is piloting a project for microfinance, and a very small portfolio of small borrowers accounts with other commercial banks, the National Bank for Development (NBD) is by far the most serious attempt made by a commercial bank to give loans to microenterprises; this program was funded by the USAID. NBD was established in 1980 and ranks the ninth in the nation in assets, deposits, and credit extended, and ranks the sixteenth in profits. It is the only commercial bank in the country that has established a separate unit to provide financing to urban microenterprises. The clients can be informal sector artisans or small businesses. The basis for being eligible for a loan is the cash flow analysis; clients usually start with smaller loans, and then become eligible for larger loans depending on their repayment history, same methodology as the NGOs discussed in the previous section. The loan size, which is between 250 Egyptian pounds to 10,000 Egyptian pounds, limits the target group to MSEs. As of June 1998, NBD's current outstanding loan portfolio for its micro operations totalled to 12.3 million Egyptian pounds. NBD's development goal for its microfinance operations is to expand microcredit to all of their branches by the year 2002. NBD lends urban MSEs on a totally commercial basis with interest and fees reaching up to 30 percent. A flat interest rate is charged as follows: 16 percent commercial rate, plus 3 percent transport cost, plus 4.75 percent non refundable insurance added to the loan amount and divided by monthly payments; this leads to an effective interest of 29.75 percent. The bank's operations reached the break-even point relatively quickly. Of the 13 branches managing micro loan portfolios, many had not yet reached the break-even point. However, the few larger and more successful branches were generating enough profit to cover the operating losses of the slower-growing branches (Dhumale et al. 1999).

Despite the fact that there is no specific legislation that encourages banks to lend to MSEs, the commercial banks are in an ideal position to extend financial services to MSEs, as could be seen from the above example. This fact was reflected in the development of the new strategies by donor organisations that broaden their support not just for NGO microcredit programmes, but to include commercial banks as well, e.g. the new strategy documents by the CGAP (2002).

3.5.2.3 The government subsidised interest model - the Social Fund for Development (SFD)

The SFD is a national fund created in 1991 by the Presidential Decree No. 40 to mitigate the adverse effects of the Economic Reform and Structural Adjustment Program. The SFD is an autonomous governmental agency working under the direct supervision of the prime minister. The SFD acts as an intermediary and executing agency responsible for the implementation of projects. Because the SFD, by its own admission, has a political as well as a socio-economic mandate, targeting unemployed graduates is one of its priorities (Social Fund for Development 1998). The SFD receives much of its funding from donors. Operating in all of the 26 governorates of Egypt, the SFD has two principal channels for MSEs' financial support. The first channel is through using executing agencies that may be NGOs, ministries, governorates, private or public institutions, and companies as financial intermediaries to administer funds in cooperation with local banks. The second channel is linked directly to the banking system. The SFD channels uncollateralised credit to MSEs through commercial banks with an emphasis on the provision of credit to new start-ups and unemployed graduates. The SFD is the largest micro and small enterprise finance program in Egypt; as of July 1998 the SFD has spent about 1.4 billion Egyptian pounds and has provided loans to about 78 thousand MSEs. The SFD also provides loans at subsidised interest rates, less than half the market rate, and provides some technical assistance. Interest rates charged by the SFD are 7 percent yearly for new projects, and 9 percent for existing ones seeking to expand. Such rates are subject to constant revision in the light of the prevailing rates in local financial institutions. The loan amount is usually between 10-50,000 Egyptian pounds per beneficiary. The loan period for fixed assets, other than land, is 18-48 months, and for the working capital it is 6-12 months (Social Fund for Development 1998).

Despite that the SFD has been openly politicised and is run like government banks, nevertheless the government remains committed to the fund. It is also not expected to become a viable model for achieving a self-sustaining expansion of financing to microenterprises, as it distorts credit markets with its subsidised interest rates and poor repayment rates (Adams and Fitchett 1992; Baydas et al. 1997b; Ministry of

Economy 1998). Furthermore, the social and economic characteristics of the microenterprise loan programmes were set up by the government to provide long-term finance for MSEs, but they adopted procedures suitable only for large projects. This has become quite apparent in the high default rates among loan recipients of the SFD program (Assaad and Rouchdy 1999).

3.5.2.4 The credit guarantee model - Credit Guarantee Corporation (CGC)

The Credit Guarantee Corporation (CGC) was established as a private sector joint stock company in 1989 with the support of the USAID. Its shareholders and directors are nine Egyptian commercial banks, and one insurance company. CGC has two main programs; the Small Scale Enterprise (SSE) program, and the Health Cost Recovery program. Under the SSE program, it issues guarantees to banks of up to 50 percent of their loans to MSEs (Ministry of Economy 1998). Claims against its guarantees have been a fraction of 1 percent, which is very low by international standards. To initiate its operations, the Ministry of International Cooperation (MIC) lent the CGC 60 million Egyptian pounds for fifty years (10 years grace on principal), to be disbursed in three equal trenches (in 1990, 1993 and 1996). These funds are held in interest bearing deposits with commercial banks as a collateral fund to pay claims under MSE guarantees issued by CGC. The main aim of this model is to encourage financial institutions, particularly the commercial banks, to lend to micro and small enterprises with viable projects and good prospects of success but which are unable to provide adequate collateral or which do not have a suitable record of financial transactions to prove their creditworthiness.

Experience from developed countries shows that lending covered by guarantees indicates a significant increase of amounts available for enterprise start-ups by individuals who lack collateral and any record of creditworthiness, and are specifically helpful in providing long-term lending to MSEs (Lamberte 1992).

The bulk of the CGC operations are financed by income from a soft loan from government and a grant from the USAID. While this does not appear to be unusual around the world, it does call into question the long-term financial viability of the CGC's approach, unless it is able to expand its guarantee activities to a much broader market. Furthermore, the concentration of CGC activities with a limited number of banks indicates that it has not been successful in marketing its activities, or that unresponsive operating habits may be limiting its activities, or that only limited demand exists for its guarantees. Moreover, guarantee fees cover only a small part of CGC's expenses (Baydas et al. 1997b).

3.5.2.5 Other models

The Leasing Model, which is among the new forms of finance in Egypt, is promoted through an equipment-leasing company. Leasing offers a potential alternative source of MSEs finance in Egypt, as it overcomes the collateral shortfalls and has a flexible repayment structure. The first leasing company was established under a new leasing law in 1997 with the help of the International Finance Corporation (IFC). In 1999, there were more than twenty-five leasing companies with a total capital of 226 million Egyptian pounds. Furthermore, banks and other financial institutions are already engaged in some informal leasing operations but without being formally registered under the leasing law (El-Mahdi and Osman 1999). This nascent leasing industry offers one of the most important models for expansion of MSEs finance in the future. It can supply nearly 100 percent of the equipment financing requirements and can match payments to specific cash flows. Leasing offers a potentially significant alternative source of MSE financing in Egypt, where small entrepreneurs have limited access to long-term borrowing.

The co-operative model is another new form of finance that exists in Egypt, which usually provides micro loans to its members. The productive co-operative sector consists of institutions, which are considered as non-governmental organisations, established by the craftsmen or individuals who centralise their efforts in professional industries (El-Mahdi and Osman 1999).

3.6 Microfinance research work in Egypt

The interest surrounding microenterprise finance programmes worldwide has generated an immense amount of literature on this subject; this is no doubt the outcome of the increased experimentation with microenterprise programmes in the developing world since 1975. On the contrary, in Egypt, where foreign funded microenterprise programmes have not been on the ground for that long, the material available is somewhat limited. Furthermore, there are insufficient theoretical models that can link these empirical studies undertaken on microenterprises with the theoretical finance models. The bulk of the research work undertaken in Egypt on enterprise finance was carried out on the small and medium sized enterprises that are part of the formal sector. The Egyptian literature on microenterprise finance can only be described as being fairly limited and weak relative to the work undertaken in other countries with comparable conditions, and relative to the funds being spent on microcredit programs in Egypt.

The research work in Egypt can be grouped into two major research areas. The first research area was mainly carried out by, or on behalf of, the donor organisations, where most of the studies focused on analysing the existing microenterprise finance programs and assessing the viability of such programs. In other words, these studies focused on the supply side of microfinance. For example, the studies carried out by (Dichter 1997) on the Alexandria Business Association (ABA) and by Dhumale et al. (1999) on the NBD, which are both financed by the World Bank, assess the viability and the sustainability of the exiting microfinance programs institutions funded by the USAID. Some studies were merely focusing on the internal organisation of local NGOs involved in finance activities (Assaad and Rouchdy 1998). In addition, there has been some academic research, including a study carried out by Abd El-Mageed (1998), which is a Masters dissertation assessing the viability of the NBD's microfinance program. Another Masters dissertation by Belke (1995) also focuses on the promotion of MSEs in Egypt and proposes a small enterprises development model for El-Kassabgy's community in Giza. It was a specific project proposal model for promotion of MSEs in the governorate of Giza based on the United Nations' development program project proposal model. Recently, in the late 1990's, the focus of research started to shift towards integrating the demand of finance into the research and not just focus on the supply side. For example, a study by Barasoum and Shaban (1999) assess the impact of the exiting microfinance programs on the livelihood of the poor households, a study by El-Mahdi and Osman (1999) assess the effectiveness of microfinance programs in creating new employment opportunities, and a similar study by Baydas et al. (1997b) was undertaken for the Ministry of Economics.

The second area of research can be grouped around the informal sector research or literature, which may include the microenterprise sector. As mentioned by El-Mahdi (1995), studies related to the informal sector started to appear in the early eighties, which indicates that this field of study in Egypt is still nascent and the work carried out overlooks and fails to mention the cultural, regional and national differences, and nevertheless, the financial needs (El-Mahdi 1995). Most of the research work undertaken was not specifically targeting microenterprise finance constraints, but studying the finance needs as part of the other needs and constrains, such as marketing, technical, and regulatory constrains. Therefore, the effective demand for finance on the part of microenterprises would at first glance appear to be quite sizeable. Most of these studies, e.g. El-Mahdi and Osman (1999) and El-Mahdi and Powell (1999), conclude that the effective demand for formal finance on the part of MSEs appears to be substantial. The MSEs' owners perceive both fixed and working capital to be their most pressing input constraint and one of their greatest assistance needs, which may be the symptom of some other problems like raw-material shortage, etc. Determining the effective demand of finance requires assessing the ability of potential borrowers to repay loans, which is lacking in most of these studies. In other words, the distinction between effective and notional demand for credit is not made in most of these studies. Few attempts were made to study the informal finance sector and its role in Egypt, such as the study by Baydas et al. (1995), and Mohieldin and Wright (2000). However these studies have not attempted to establish the link between the informal financing sector and financing the business enterprises.

This limited research work in Egypt can be attributed to the difficulties that are often encountered in gathering data to determine the effective demand for credit on the microenterprise level. However, this reason does not justify the weak methodology used in such studies. Furthermore, this belief in the existence of credit constraints is often based on results from surveys in which microenterprise operators are asked to indicate whether the lack of credit is a problem or not, e.g. El-Mahdi et al. (1999).

Furthermore, most of these studies, even the donor funded ones, were carried on the assumptions that microfinance plays a vital role in alleviating poverty and creating jobs, but there were no rigorous empirical research carried out on those assumptions. In addition, the finance gap revealed by some of these studies, as shown in table 3.5, is based on mere estimation and not on rigorous academic studies, e.g. Crump (1996), Siam (1996), Brandsma and Chaouali (1998), Ministry of Economy (1998), and Dhumale et al. (1999). Table 3.5 shows that the estimated finance gap is approximately 1.5 billion Egyptian pounds (371 million U.S. Dollars), and that the existing formal and semiformal finance programs, in total, did not reach more than 5 percent of the potential beneficiaries (Brandsma and Chaouali 1998; Ministry of Economy 1998).

Table 3.5: Financing and outreach gap for microfinance in Egypt in $US.

Country	Number of potential borrowers	GDP per capita US dollar	Potential outstanding microfinance	Current outstanding microfinance	Financing Gap	Number of current active borrowers	Outreach gap
Egypt	1,550,000	832	425,568,000	54,938,000	370,630,000	74,635	1,475,365

Source: (Brandsma and Chaouali 1998) page 37.

The previous table's calculation is based on the assumption that 50 percent of the people living on less than 7 Egyptian pounds a day (33 percent of the GDP) will need credit. However, are these people willing to borrow? Do they have the capacity to borrow or can they mange profitable activities and increase their standards of living? Such questions are not answered by most of the previously discussed studies.

3.7 Summary and conclusions

This chapter reveals that as the consensus grows in Egypt around the need for economic reform, microenterprise finance initiatives start to grow as a means of promoting microenterprises development. Egypt's interest in the microenterprise sector has been mounting since the early 1990s. The microenterprise sector is fairly placed on the Egyptian government's development agenda; it is using it as a quick solution to the current economic situation, as the Egyptian government values stability above economic reform. However, this microcredit commitment policy is coupled with little knowledge of how it can best be implemented. The Egyptian government see credit programmes as an easy way to increase the flow of capital, but they forget that credit doesn't necessarily represent capital. Merely increasing the supply of money does not create capital, nor can capital be used developmentally, if borrowers are permitted to use their borrowing for consumption (Padmanabhan 1988). What can be concluded from the Egyptian government's experience so far with microenterprise financing is that it is using microcredit to lure microenterprises; i.e. luring the informal sector, which includes the microenterprise sector, into the formal economy as a means of broadening the tax base.

The survey done in this chapter reveals that despite the fact that the microenterprise sector dominates the Egyptian economy, there is no uniform definition adopted by the government. The Egyptian government have defined various sizes of enterprises according to more than one classification criteria. This lack of a unified definition results in faulty classification of enterprises, which may hinder policy makers, and those in charge of microenterprise development and application. Furthermore, this lack of a uniform definition may lead the government and donor agencies to use the limited resources to help enterprises that may not be in need of the assistance. Government and donor agencies may expand resources to remove credit constraints on people who do not face such constraints. This could lead to the misallocation of the society's resources, which could be used to remove other important barriers to MSEs growth.

This chapter has also revealed that the supply of finance to the microenterprise sector in Egypt, especially in the last ten years, is available through different forms, whether through the formal, semiformal or informal finance. Different financing models are used to reach microenterprises through NGOs, banks, and the government agencies. These financing models are relatively available in most of the urban areas, and an enormous amount of capital is finding its way into the economy through the informal finance sector as well, e.g. *Gam'iya*, supplier credits, money keepers, partnership, migrants, and relatives, etc.

This chapter has also shown that very few among the large number of technical and financial institutions claiming to help the microenterprise sector in Egypt are effectively active, and very few are concerned with helping the starting up of MSEs. The only program that has targeted start-ups for microenterprises is the SFD. Furthermore, the majority of other programmes were not targeting the poor but were targeting the MSEs that can not access the formal sector due to the lack of formal collateral. Therefore, this study focuses on the microenterprise as the unit of study regardless of whether it is poor or not. The microenterprise sector is not necessarily the society's poor or the underprivileged. However, MSEs are systematically excluded from commercial bank lending as they often lack any sort of traditional material guarantees.

Furthermore, this study revealed that many researchers, analysts, and policy makers in Egypt believe that credit constrains are among the major factors limiting the contribution of MSEs to employment, income generation, and poverty alleviation without the true assessment of the real demand for finance in Egypt. This acute shortage of finance supply, as claimed by several studies, especially in urban areas, is not strongly substantiated with a rigorous empirical work. The literature justifying the real demand for microenterprises' finance is not clear enough, and enterprises have been successful without credit. Hence, this study attempts to make a contribution towards filling this gap. A fuller understanding of the true demand of microenterprise finance can help in developing better financial products for the microenterprise sector.

Chapter Four: Research Methodology

4.1 Introduction

Despite the growing body of literature which identifies various problems associated with the financing of microenterprises, the understanding of the underlying issues is far from clear, and many of the research findings are contradictory. The frequent identification of finance as the primary obstacle for developing the microenterprise sector is based on a fairly weak methodology, especially when the source of data used is based on the enterprises owners' subjective responses (Baydas and Graham 1995). If the finance is the problem that it is often made out to be, then how is it that many MSEs were able to prosper and grow (Lamberte 1992)? The main reason for this situation has been the lack of rigorous analysis in the previous studies, and it has been argued that several methodological challenges have limited the clear understanding of the relationship among the different forms of finance and owners' credit choice. There has been a variety of methodologies employed that findings sometimes appear to be methodology dependent (Read 1998).

Therefore, in this chapter, firstly, a number of the most common methodological flaws are explored in detail. Secondly, the issues and arguments behind the choice of the approach adopted for this research are examined. Thirdly, the major aspects of this sampling strategy: the population, the area of study and the study sample are considered. Fourthly, the data collection method and the features of the questionnaire used, and their preparation, are discussed. Fifthly, the methods used in the analysis and the tabulation of the collected data are explained briefly. Finally, a summary and conclusions are presented.

4.2 The methodological shortcomings of the existing research

There are numerous difficulties faced by researchers in this field regarding the aspects of the research methodology. Major methodological shortcomings or problems of the existing research in microenterprise financing can be divided into the following.

The first problem, which is the major barrier to any research on microenterprises, is the lack of an appropriate national database to make the construction of a representative sample possible (Read 1998). Many microenterprises run their businesses from home on a small scale and thus remain largely invisible to the official statistics. Hence, many researchers in the field of microenterprise have resorted to drawing samples on the basis of convenience rather than design. This has led to concerns over how representative many of the findings are to the population of microenterprises as a whole (Mordouch 2000).

The second problem faced by researchers in this sector is choosing the unit of analysis under study. Some researchers concentrate on the economic unit, whether an enterprise or an individual e.g. Baydas et al. (1997b), other researchers choose to consider the family or the household to be the unit of study e.g. Barasoum and Shaban (1999). Even some studies have attempted to use a mix of different unit of analyses, such as Sebstad et al. (1995), Hulme and Mosley (1996a) and Dunn (2002) who looked at the microenterprise, household, community and institutional levels at the same time. These different units of analyses contribute to making results comparison of different studies very difficult.

The third problem, even among the studies that focus on the enterprise level as a unit of analysis, is the wide range of disagreement on the microenterprise definition, and whether the number of employees or the capital invested in is used as a criterion for definition or both. Even if the number of employees is used as the only criterion for definition, there is a wide disagreement on the exact number of employees that differentiate between micro and small or even medium size enterprises, as previously discussed in detail in chapter one. This lack of a uniformed definition affects the results and the recommendations of these studies, as microenterprises have unique characteristics compared to small and medium enterprises.

The fourth problem is the heterogeneity of this sector as could be seen from chapter three, table 3.3. Finding the most meaningful way to classify these enterprises is one of the great and unresolved challenges facing researchers seeking to understand the microenterprise sector (Liedholm and Mead 1999). Different researchers have used different classifications, such as location, gender of the entrepreneur, activity, or the degree to which the enterprise obeys the laws and regulations. Those different categories face different problems and constrains; therefore, results cannot be generalised or compared. Hence, results might not apply broadly, and there would be sharp differences in constraints across sectors. However, as mentioned by Levy (1993), constraints associated with finance are likely to be similar across different sectors or categories.

The fifth problem is the fungibility of money; because of fungibility, several researchers, e.g. Morduch (1999), find it difficult, if not impossible, to draw a clear and unambiguous line between investment and consumption. Fungibility of money presents a critical issue in the study of the effects of loans borrowed form the informal or the formal sector, even when borrowers explicitly state their reasons for borrowing. This can be seen as a difficult problem, as no study has successfully controlled the fungibility of resources between the household and the enterprise. Despite this fact, it is possible to control for fungibility by attempting to crosscheck the actual loan usage against the intended loan use and estimate the leakage (Mosely 1997; Hulme 2000).

The last problem is due to the fact that there are relatively few studies that have targeted specifically the issue of microenterprise finance demand in Egypt. To the best of the researcher's knowledge, the research work in Egypt is limited to findings from more general surveys of the characteristics and problems faced by the informal sector in general, which may include the microenterprise sector, whether it is undertaken from a macro, micro or pectoral perspective (e.g. El-Mahdi and Osman 1999; El-Mahdi and Powell 1999; Mohieldin and Wright 2000). This scarcity of detailed data in Egypt about the funds that the microenterprise sector raise in the informal debt markets, in the private equity or in the formal financial markets, are among the major constraints in quantifying the results of this study. Hence, most of this study's results comparison will be from studies carried out in other countries.

4.3 Choosing a methodological approach

4.3.1 The evolution of the quasi-experiment approach

Among the scientific methods that seek to ensure that effects can be attributed to causes is the experimental approach, where a particular stimulus can be traced to a particular object in a rigorously controlled environment and judged to be the cause of the observed effect. This experimental approach is virtually infeasible in the social sciences, because of the nature of the subject matter; hence, a quasi-experimental approach is used (Mosely 1997; Hulme 2000). The term quasi-experimental refers to a research design that has most aspects of an experiment. It has a treatment or intervention group, and a control or comparison group whose experience serves as a baseline against which the effects of intervention can be measured. The major difference between experimental and quasi-experimental design is the random assignment of participants. The comparison group is selected after the intervention has happened, but in a manner that permits isolating the intervention effect (Campbell and Stanley 1963). The non-participant group is called a control group when its members are randomly selected; otherwise, it is called a comparison group. In this study the non-participants are referred to as the comparison group; non-borrowers of formal loans (informal borrowers group), as will be mentioned in the next section. The respondents in the comparison group do not receive formal loans, but they are considered similar to the treatment group in the critical characteristics that are expected to affect outcomes (Dunn 2002).

In a quasi-experimental design the outcomes of an intervention is compared with a simulation of what the outcomes would have been, had there been no intervention. The quasi-experiments have two methods, one of which is multiple regression, but this has rarely been used because of its enormous demand for data, the causal factors and assumptions (Mosely 1997). The second method is the control or comparison group method that has been widely used. The control or comparison group approach, unlike regression analysis, cannot tell us the quantitative relationship between the two groups. However, on the other hand, it is free of biases associated with regression analysis, especially in those cases where the standard assumptions of the normal linear regression model, normally distributed disturbances, and the constant variance of the error term, etc., do not hold (Mosely 1997).

The quasi-experimental approach has been used widely and derived its basic statistical experimentation from fields such as agriculture research and medicine. It was used to assess the effects of specified fertilizer treatments on a particular crop, to assess the effect of specified drugs on a particular type of patient and, more recently, it has been brought into use in the social sciences (Mosely 1997). There exists a wide body of literature utilising this method for the empirical research, especially in microfinance impact assessments research literature.

4.3.2 The reasoning behind using the quasi-experiment approach

This approach has a lot of benefits as it determines the effectiveness of the predetermined factors through a rigorous comparison of an intervention group, those receiving formal loans, and a comparison group, non-borrowers of formal loans. It is a very popular approach and most of the good evaluation practices are associated with this method (Hulme and Mosley 1996a; Mosely 1997; Hulme 2000; Dunn 2002). Furthermore, it enables us to look at what is already in place; it draws on the existing data sources, and thus is often quicker and feasible to implement.

The quasi-experimental designs do not assume certain behaviour in the surveyed population, as many econometric models do; nevertheless, they allow two sample groups of enterprises to be compared on a certain issue factor. They analyse uncontrollable situations in an experiment like fashion by using a comparison group and by using statistical procedures on the comparison variables; i.e. by holding the comparison criteria constant, assuming that all the relevant criteria have been selected and correctly identified. This way, the effect of finance can be isolated and statistically significant differences between the two samples can be attributed to the microenterprise owners' choice. Also, the quasi-experimental designs increase the confidence that observed outcomes are the result of a given variable instead of a function of unrelated variables or events (Read 1998).

4.3.3 Limitations of a quasi-experiment and steps to overcome them

Despite the advantages mentioned in the previous section, this approach can be problematic if the limitations, sampling needs and the choice of the comparison group, are ignored. As mentioned by Mosely (1997), Read (1998), Hulme (2000) and Dunn (2002), while the quasi-experiment approach may seem simple, a number of traps may befall its user, in particular, problems of sample selection bias, misspecification underlying causal relationships, and respondent motivation.

Selection bias stems from the fact that people self-select whether or not they will apply for microfinance institutions' programs; program managers and credit officers also select service areas and individual clients on the basis of their likelihood of succeeding. Selection bias may also occur because of difficulties in finding a location at which the economic, physical and social environment of the comparison group matches that of the intervention group. Furthermore, individuals may choose to borrow from formal sources because of a pessimistic perception of the alternatives available to them outside this source or program. If their perceptions are based on a realistic assessment of their opportunities, participants' outcomes, in the absence of formal borrowing sources, would be lower than those of non-participants with identical observable characteristics; thus the two groups would not be comparable. If differences between formal borrowers and informal borrowers relate to the ability to realise benefits from formal borrowing sources, this could lead to differences in the outcome variables (e.g., income and revenue) as well (Sebstad et al. 1995; Dunn 2002).

Also the intervention group may systematically possess an invisible attribute which the comparison group lacks, or may be inherently different, and these differences may lead to incorrect measurement of the intervention effect. Furthermore, receiving any form of intervention may result in a short-term positive response from the intervention group, formal borrowers group, which may affect both the decision to borrow and its outcome (e.g., ability or motivation). This difference in characteristics that cannot be observed by the researcher may lead to different respondent motivation and relationship (Dunn 2002).

However these problems can be tackled by the more careful selection of the comparison group so as to hold constant the factors that may vary between the intervention and the comparison group. Also the use of longitudinal data, as will be described in detail in section 4.5, can reduce the selection bias as mentioned by Sebstad and Chen (1996).

Hence, in the light of the above issues and taking into consideration the comprehensive understanding of the basic underlying processes, this study has five possible matching criteria, or moderating variables, that are likely to distort the comparison, and can be easily isolated or measured prior to the interview in order to avoid wasting time and effort. Since, matching subsequent to the interview is generally inefficient, as many non-matches will have to be discarded, for example the value of total assets or turnover was difficult to obtain before any interview. This criterion was matched in the case where there were more than one comparison sample to select from, as will be discussed later; the closest as possible value as seemed from the observation was selected. These matching criteria or moderating variables were included in the analysis in order to help statistically explain variations in outcomes, thus providing a more powerful and precise analysis (Dunn 1996; Sebstad and Chen 1996; Dunn 2002).

It is worth mentioning that these limited numbers of key variables were chosen, as it is impossible to match on every possible criterion, and the matched pairs are not meant to be identical pairs. Despite the fact that by limiting the matching criteria the researcher risks omitting an influential factor, too many criteria will reduce the chances of finding sufficient pairs (Read 1998). A one to one matching was implemented to select a similar microenterprise not receiving formal loans, a comparison group, based on the five matching criteria or moderating variables. The five matching criteria have been chosen for the following reasons:

- Location: the two groups were chosen from the same or comparable location in terms of exposure to finance sources and market, which allows us to control for access to financial resources, infrastructure, and market factors that have a key influence on input and output prices as well as other variables.
- Size of employees: enterprise size is usually of significant importance to lenders, as they may perceive larger businesses as being more secure. The total number of employees of any kind, part time and full time, are the measures employed. While it is recognised that a business with full-time employees might be very different to one with part time employees, it would have been almost impossible to match on numbers of each type of employees. As mentioned by Buckley (1996), it is very difficult to measure properly the changes in real employment, as it is notoriously difficult for many microenterprises to distinguish between full-time, part-time and casual employment, because employees can successively qualify for each category in any given time period. In the matching criteria an attempt was made to make the difference in employees' number of the two groups not to exceed two employees.
- Activity type: both samples of the matched pair have the same activity type as to control for different types of activity problems, and to insure their exposure to nearly the same market and regulation problems. Furthermore, financing requirements may differ between sectors, and lenders may prefer to finance different sectors, particularly those that are able to offer fixed assets.
- The enterprise age: the year of starting the business of the matched pair was almost the same and not exceeding three years difference unless it is over 15 years old, where this three years upper limit difference is relaxed. The business age has a great effect on finance resource availability. The older the enterprise is in the market, the more finance will be available because of its established reputation. Furthermore, the enterprise age is one of the most important criteria used by financiers as a measure for financing risk (Read 1998).
- Gender of the enterprise owner: the matched pairs have the same gender, as the gender type is one of the major factors that affect credit terms, especially in developing countries.

4.4 Sampling strategy

The survey is confined to urban microenterprises in the private sector only in Egypt as the unit of analysis. The rural sector has relatively received its fair share of research and support through direct credit programs since the 1950's from the government and donor organisations. Also linking poverty to microenterprise was disregarded in this study, as poverty is not always the norm. Microenterprises are not poverty stricken enterprises but nevertheless their businesses are very small that they could not offer collateral or be accepted among the main stream of the formal credit market. Microenterprises do not keep any formal records, and they demand credit amounts that are considerably lower than minimum loan amounts of commercial banks. Hence, microenterprises are systematically excluded from commercial bank lending due to lack of assets; very few formal financial institutions such as banks lend to such clients in Egypt, as was discussed in chapter three. Furthermore, a number of recent works, e.g. Hulme and Mosley (1996a) and Hulme and Mosley (1997), demonstrate that the poorest of the poor often derive few or no benefits from microcredit programs and, in many instances, can be disadvantaged by such credit schemes. To use credit effectively, a minimum economic level has to be reached or it may lead to increasing the relative disparities of the user (Montgomery et al. 1996).

In the light of the fact that there is no national database for microenterprises and that many microenterprises remain invisible or informal, the task of finding a pool of microenterprises from which to draw matched pairs was not an easy one. Therefore, the intervention group sample of microenterprises was randomly selected from an NGO microcredit programme database in one of Cairo's neighbourhood, as discussed in detail in the next section.

4.4.1 The nature of the study area - study population

Cairo, the Egyptian capital, with more than 13 million inhabitants has a population density of over 32,000 per sq. km., is often regarded as one of the world's mega-cities. Cairo, is seen to concentrate within its extended limits the country's economic and social problems (Sutton and Fahmi 2001). The sample was drawn from a local NGO operating in Shubra. This is one of Cairo's large neighbourhoods or districts. It is a densely populated working-class district in northern Cairo. It houses over three million people. It is an area that has been, by the Egyptian standards, well served by the banking facilities. It has more than eleven bank branches, and even three post offices with saving facilities. Furthermore, there are three NGOs with lending programs, semiformal institutions, operating in this area and competing with each other for the same clients.

4.4.2 The choice of the NGO

Historically, the provision of microfinancial services to low-income persons, whether by banks or non-governmental organisations (NGOs), was consisted of an assortment of pilot projects and innovative ideas. NGOs have been leading the field in lending to the microenterprise sector. There has been a proliferation of NGO's that run microcredit programmes in Egypt, as was highlighted in chapter three. The Coptic Evangelical Organisation for Social Services (CEOSS) is one of the largest social services agencies operating in Egypt. CEOSS has two major lending programs; the poverty-lending programme and the Credit for Self-Employment and Small Enterprise programme (CSSE). The rationale for these programmes tends to be economic rather than social, with an allegation that improved performance of assisted businesses will have positive employment and income benefits for the poorer population. They mainly provide loans to entrepreneurs who lack traditional collateral, business records, or an established credit history. The poverty-lending programme provides loans up to 3,000 Egyptian pounds with personal guarantee only; this programme is mainly targeting the poor.

The second CEOSS credit programme, the CSSE programme, from which the sample was selected, provides fixed and working capital loans to both existing and new enterprises. However, more than two thirds of the portfolio serves existing enterprises, which are able to access and make effective use of CEOSS's financial products. This programme helps people who lack access to conventional financing to establish or expand small businesses. This programme offers loans up to 15,000 Egyptian pounds with, usually, a loan term of 12 months. A copy of the business registration, post-dated cheques, or salaried government employee guarantor are used as a guarantee for the loan. The loans' purpose should be for productive activities only, and are monitored by the CEOSS staff. It should be noted that this procedure allows this study to control for the effect of fungibility previously discussed in section 4.2. This NGO adopts a policy of loan increment for recurring borrowers; i.e. securing a new loan depends on how a person has handled the past debt obligations. Flat interest is calculated on the entire loan amount, rather than on a declining basis; therefore, the 12% flat interest results in an effective interest rate of 21.50%; which is above the market interest rates. This higher interest rate is justified by CEOSS as to cover the high transactions costs.

This programme has over 4000 clients of which 673 clients are in Shubra, from which the sample was selected. This NGO, CEOSS, was selected for the following reasons:

- CEOSS works in one of Cairo's highly densely populated urban areas; i.e. Shubra, which gives the researcher the opportunity to select a rich diversified sample from the same geographical location and hence control for the location bias.
- CEOSS has been working in the field of micro and small enterprises finance from the early 1990's. Therefore, it enabled us to select the intervention sample from clients that have loans at least more than six months in order to effectively monitor their effects.
- CEOSS defines its target clients in the same way as the definition adopted in this study; i.e. a microenterprise as composed of 1-5 workers and a small-enterprise as composed of 6-15 workers.
- CEOSS' lending methodology and procedures control for the fungibility by controlling the use of funds borrowed; i.e. sending the credit officer to check the actual usage of the loan.
- CEOSS adopts what is known as the minimalist approach in lending. The minimalist approach is a term used by NGOs to describe the functioning of those microcredit schemes where credit is given without any other parallel forms of business support. Therefore, by giving loans only without any type of services, the effects of these loans, when compared to non-borrowers (informal borrowers), can be easily isolated.

4.4.3 The sample size

In Cairo, the research was conducted for around three months during the period from January 2001 to March 2001, which is usually the time for microenterprises to submit their tax return. This timing helped the respondents in recalling quantitative data easily. The sample size was limited to 95 microenterprises as shown in table 4.1. The time limit necessitated a reduction in the sample size, which could have been extended to include a larger sample. The sample is divided into two groups of microenterprises. The first group of the sample, the intervention group, the formal borrowers group, is composed of 50 microenterprises which receive loans from CEOSS. The second group, the comparison group, which will also be referred to as the informal borrowers group, is composed of the rest of the sample (45 microenterprises), and they are non-recipients of formal credit, but could be recipients of informal credit.

The intervention group sample of 50 microenterprises was randomly selected from CEOSS' database, which contained 673 microenterprises with outstanding loans in Shubra's area. The sample was inflated by 10% to compensate for any potential non-respondents. To minimise any biased selection of the sample, the intervention group was selected according to a random sampling method that enables the results to be generalised to the wider population. This was done through selecting every 10th sampling unit of the population, which was 673 microenterprises, after the first sampling unit was selected at random from the sampling units. The entire sample is above six months old clients as the list, credit ledger, from which the sample was selected was arranged by date. It was important that the microenterprise owners had started the enterprise in order to be able to discuss questions relating to start-up finance. In situations where there were two or more owners of the enterprise the interview was undertaken with the one in charge of the finances and who usually deals with the financial matters. The sample chosen was 55 and, as expected, three of the microenterprise owners could not be met, and two refused to participate in such an interview (questionnaire) as they considered such questions to be personal and of a private nature.

As for the other group, the comparison group was not selected randomly because there was no list to sample from, and in order for the comparison group to be as similar to the borrowers of formal finance as possible. It is worth mentioning that identifying the comparison group, the informal borrowers group, sample in urban areas in Cairo proved to be much more challenging. This study relied especially on the formal borrowers, the intervention group sample, to identify neighbours, friends, and relatives who are carrying on similar businesses without formal loans. The formal borrowers' microenterprises were requested to identify 2 or 3 microenterprises that are close to their business and have the same activity and if they think that they do not deal with the formal credit. Some of the formal borrowers group could not identify such microenterprises; hence, this study had to depend on the Random Walk Client-Match method to identify such clients. This was one of the main reasons that the same 50 samples as the intervention group could not be matched.

Table 4.1: Total sample distribution by gender.

	Gender	Frequency	Percent
Intervention group (Formal Borrowers)	Female	4	8.0
	Male	46	92.0
	Total	**50**	**100.0**
Comparison group (Informal Borrowers)	Female	2	4.4
	Male	43	95.6
	Total	**45**	**100.0**

In total, 119 microenterprises were nominated. For an interview, 37 could not fit the matching pair criteria, especially the gender criteria, as could be seen from table 4.1; finding female microenterprise owners was not an easy job. Also, 41 refused to answer the questionnaire, as they lack the motivation, and additional four microenterprises were selected through the Random Walk Client-Match Method. This resulted in having the comparison group limited to only 45 microenterprises, which were also not easy to interview as discussed in section 4.5.2. The comparison group sample includes microenterprises that are not potentially getting any formal finance during the same period involved. That is why this group, comparison group, sample was selected from non-members, who are not even on the waiting list of a credit program, as done by other studies e.g. Hulme and Mosley (1996b). Those non-formal borrowers are rarely surveyed and infrequently studied in depth except when they belong to industries that are officially promoted.

4.4.4 The limitation of the sample population

Limiting the study to the area of Shubra raises the question of representation, or in other words to what extent this area is representative of the total urban microenterprise population in Egypt. However, as mentioned by Gibb in Read (1998) the search for a representative sample in any small enterprise's research is so difficult as the small enterprises are so diverse.

There are several factors that potentially may restrict the conclusions to be drawn from the study. Firstly, because the intervention sample was selected first, it is likely that the structure of the sample is influenced by the characteristics of the microenterprises applying to deal with this specific NGO, CEOSS, particularly during the start-up.

Secondly, the sample may contain a higher percentage of Christians than in other areas, which reflects the nature of this area, which is among the higher concentration of Christians in Egypt, as they represent over 30 percent of Shubra's population. It could be seen from table 4.2 that the formal borrowers who deal with this Christian NGO are mainly Christians; i.e. 54 percent of the first group. This fact may have a distorting effect on some of the aspects of the data collected, for example, attitudes towards credit. However, as could also be seen from table 4.2, the total Christians percentage is 40 percent, which is very close to the real percentage of Christians in this population.

Table 4.2: Sample distributions by owners' religion.

	Formal Borrowers		Informal Borrowers		Total Sample	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Christian	27	54.0	11	24.4	38	40.0
Muslim	23	46.0	34	75.6	57	60.0
Total	50	100.0	45	100.0	95	100.0

Aside from these limitations, the results of the survey are generally applicable to the rest of the urban areas all around the country, based on the fact that the Egyptian society is homogenous, as previously mentioned, and any segment of the population should be a fairly accurate representation of the population as whole. Nevertheless this study does not claim that the sample is a representation of all of the urban areas in Egypt.

4.5 Data collection procedures

Given the study questions and hypotheses, the most appropriate method of collecting the information was through a pre-structured questionnaire. This pre-structured questionnaire allowed for an element of comparability and consistency across interviews for the purpose of the analysis. One of the best ways of acquiring and reducing uncertainty about information is by interviewing borrowers and inspecting their place of business. Data have been collected in this study through direct interviews using prewritten questions. Face-to-face interviews have been carried out at the different microenterprise locations to avoid conducting interviews at the premises of the semi-formal financial organisations, i.e. CEOSS, as the researcher believed that such a setting could limit the respondents` self-expression and inhibit them from expressing views that might be in disagreement with that of the organisation. Also, visiting the premises of a microenterprise gave the data more reliability and increased the researcher's opportunity to eliminate any possible misunderstandings of questions by the respondents; some respondents were illiterate and the questionnaires would not have generated any information in such cases. This also allowed for confirmation of much of the economic data through alternative evidence, e.g. observation and cross checking of respondents answers. Furthermore, it helped in reducing the number of missing answers.

4.5.1 The questionnaire

The questionnaire include both quantitative and qualitative questions to make it richer in its exploration of experiences, opinions, feelings, and knowledge of the microenterprise, in addition to telling us more about what is really going on.

Qualitative studies require a higher level of sophistication from interviewers and more time in order to obtain internally reliable information (Sebstad et al. 1995). The questionnaire includes data on income and expenditure, and increase in labour. The questionnaire, as shown in appendix A, is formulated in such a way so to avoid the difficulty of obtaining accurate data from microenterprises which keep no books, as their owners may be reluctant to share detailed or precise information with outsiders.

The same set of questions was asked to the two groups. The questionnaire was prepared taking into consideration that the comparison group is not there merely to act as a comparison group; the fact is that it is also an interesting group in its own right. The questionnaire contained four parts. It identifies finance sources utilised at three different situations; including start-up, ongoing operations and future investments. The data collected for any one enterprise do not relate merely to its condition at a point in time. Rather they represent a case history in most instances stretching over several years, in others for more than a generation, since their founders had handed down several enterprises to their children; i.e. the information collected in the interviews has been presented as a series of some 95 case studies. Despite the fact that a cross-section study was conducted due to constrains of time and resources, retrospective panel data was drawn from this survey, as respondents were asked about outcome variables in two or more time periods in order to minimise the selective bias. Moffitt in Sebstad and Chen (1996) mentions that the availability of longitudinal data can eliminate the selectivity bias that would be present in only a single cross section of data. Longitudinal data sets contain two or more measures over time. Panel data, a specific type of longitudinal data, result from interviewing the same respondents on the same variables, measured at more than one point in time. There are two types of panel data that are important: prospective panel data, drawn from multiple surveys that occur at different points in time, interviewing the same respondents and measuring the same outcome variables each time and retrospective panel data, drawn from a survey that occurs only once, with respondents asked about outcome variables in two or more time periods (Sebstad and Chen 1996).

The design of the questionnaire took into consideration that the questions should be worded in such a way so as to make it easy for the respondents to understand, and answer the questions in a clear fashion; in addition, a room was allowed for unexpected responses. This questionnaire consisted of four major parts containing a total of 56 questions (given in appendix A). Those four parts are:

- Part one: Characteristics of the microenterprise owners. It mainly includes information about the background of the owners including information on their sex, age, education level, marital status, and children.
- Part two: Characteristics of the microenterprise. It includes information about the history and development of the microenterprise capital, the type of ownership of business, business assets development and sales revenue and net income.
- Part three: Financial performance of the microenterprise. It identifies sources of funds utilised at three different situations; including start-up, ongoing operations and future investments. Furthermore, it attempts to investigate source preferences for financing the ongoing operations.
- Part four: Attitudes of microenterprise owners towards financial matters. It identifies attitudes of microenterprise owners towards subjects related to financial matters and the extent to which a range of factors have constrained the growth of their businesses.

The questionnaire has been initially tested on some colleagues and microenterprises, and their remarks and comments have been taken into consideration before carrying out the final interviews. A pilot study was conducted to improve the structured questionnaire, and to measure the length of time taken to answer the questions and improve the clarity of any questions, which may have been vague or difficult for respondents to answer. The pre-testing of the questionnaire was carried out exactly as it would be performed in the main study, 5 cases from each group. This has led to the reduction of the number of open questions, i.e. those having an open-ended format, and supplementing the questions with appropriate response categories to facilitate the data analysis. Also this step resulted in restructuring several negative format questions and reducing the overall number of questions to be asked to every respondent.

4.5.2 Difficulties faced during data collection and questionnaire reliability

As the questionnaire was administered through face-to-face interviews, several difficulties were faced during collecting the data. The first group, which is the intervention group or formal borrowers group, was the easiest group to approach as generally they accepted answering all of the questions, as one of the unavoidable transaction costs of dealing with an NGO or formal institutions. Having been introduced by the CEOSS's credit officer enhanced their motivation. That is why the study target of interviewing 50 microenterprises was achieved. As for the comparison group or the informal borrowers group, finding microenterprises in an urban area has shown to be a challenging job; that is why only 45 microenterprises could be matched, as previously discussed in section 4.4.3. As for both groups, there were a number of barriers that had to be overcome in order to obtain reliable data.

Given the fact that the majority of the questions were dealing with finance issues, the first barrier was that the microenterprise owners were often reluctant to discuss such issues. Income is typically regarded as confidential and sensitive information. Some of the microenterprise owners were concerned that their views on the formal finance institution, NGO, should remain confidential. It was often the case that, after the questionnaire had been put away, the microenterprise owners, respondents, were prepared to reveal more openly their opinion. Therefore a lot of information was obtained during the informal chats that frequently followed the formal interview. To counteract this problem, as recommended in Read (1998), the questionnaire was designed so as to keep the more sensitive questions until later on in the questionnaire, till a trust has been established.

The second barrier was the desire of the microenterprise owners to appear to be better off. This prestige effect may result in a tendency to inflate their income or blame outside parties for their lack of success. As explained by Gibb in Read (1998), those who work closely with the small enterprise owners will know that, in response to questionnaires about the kinds of problems that they face most will place emphasis on the environment or events which are seen to be directly outside their personal comparison. Carrying the interview at the client's premises helped us in reducing this prestige effect. Furthermore, financial data were cross-referenced with the available data collected by CEOSS's credit officer to review consistency, e.g. profit margins.

The third barrier was the tendency for many microenterprise owners to discuss issues which interested them but which were irrelevant to the study. Microenterprise owners find that the presence of a researcher offers them the opportunity to talk about issues such as personal problems, which is irrelevant to the research, but the researcher had to listen to them. Given the limited time available, the conversation had to go back to the line of questioning, which required both diplomacy and patience.

The fourth barrier was that while the questionnaire was designed and piloted with some particular questions, still ambiguities in interpretation of certain questions varied from one respondent to another to some extent, for example, one respondent was unsure as to the meaning of the term turnover. The problem is that different people understand and interpret meanings differently; therefore it was necessary to gauge the individual's level and offer as much extra clarification for certain questions as necessary. Performing the questionnaire personally helped in clarifying such ambiguities.

The fifth barrier was that in a face-to-face survey the microenterprise owners might be telling you what they think you want to hear. The respondents could be influenced by their perceptions of what seems to be a desirable response rather than indicating the actual use of different finance sources. Because of this, many researchers advocate estimating income indirectly from other data, or collecting information on sub components of income separately, instead of asking for the total income information directly. Using an appropriate frame of reference e.g. reviewing the respondents' files at the CEOSS and observation helped to build a clearer image.

The sixth barrier is that the majority of the microenterprises generally had no written accounts from which it would be possible to calculate the revenues and profits of the businesses. Very few microenterprise owners make any distinction between enterprise income and their own wages, or keep written records of any kind. Because of the poor record keeping and a lack of cross referencing, most of the research data in this area tend to be more qualitative than quantitative, which limits their use in statistical analysis. However, as mentioned by Harper (1998), it is possible to overcome this problem by obtaining rough but reliable useable data through personal contact, an hour or two of focused discussion with the owner, combined with the perceptive observation of his or her microenterprise can elicit the market value of whatever simple fixed assets may have, and it is similarly possible to obtain information about income and expenditure and thus make an estimate of the net earnings.

The final barrier was the depending on microenterprise owners recalled data. Recalled data are subject to inaccuracies and distortions due to the length of time between the actual event and the act of recall, which affects the quality of information collected (Liedholm 1992). Therefore in this study the recall period was, generally, limited to 12 months only. Using the 12 months recall period assist in reducing the great variation in terms of measurement (e.g. fluctuation of income) and in avoiding the seasonality effects. Furthermore, the difficulty of the microenterprises owners' ability to estimate their profit, costs, and earnings in this questionnaire was assessed. It was 95 percent as will be discussed in detail in chapter five.

4.6 Analysis and tabulation of the data

Establishing a strong plausible case for attribution is another conceptual challenge in this study. As mentioned by Dunn (2002), statistical methods can establish statistical correlation, but they cannot prove the existence of a cause-and-effect relationship. It can never be shown beyond doubt that an intervention leads to the desired effect. Instead, the best that can be done is to establish a strong case for attribution.

The data collected were analysed with the help of a computer software package called the Statistical Package for the Social Sciences (SPSS). A wide variety of statistical techniques were used with the quasi-experimental design. The data collected were analysed using several complementary approaches in order to investigate the relationship between variables. Non-parametric tests were used because the sample size was small, the cell sizes were unequal and, more importantly, the assumption of equal variance of the cells could not be made. Conover (1980) and Siegel et al. (1988) argue that nonparametric tests are more powerful and efficient than parametric methods, if the assumptions behind the parametric tests are not met.

In chapter five the data collected are tabulated in statistical tables and presented in the form of statistical charts and diagrams. Such presentation helps the reader to appreciate visually the salient characteristics of the data. Cross tabulation was mainly made to test the level of significance between the dependent variable and each independent variable. This helped to identify contributing measures as well as to eliminate irrelevant ones. The chi-square method of cross tabulation, which is in fact a test of independence, was used were appropriate, and caution was exercised in interpreting data when percentage of cells with an expected frequency of less than 5 is more than 20%. Also, the Mann-Whitney U test of significance to measure statistical significance of the distribution of the two groups was used.

4.7 Summary and conclusions

This chapter has outlined the methodological procedure of the study and discussed in detail the reasons why a specific research technique was employed. The various research techniques were reviewed and the advantages and disadvantages of each were discussed, while an experimental design is the preferred way to address the problem of selection bias, it is often not feasible. Therefore a non-experimental design using the key moderating variables that were believed to affect the relationship between the two groups of respondents was used. This chapter also explained the make up of the population of the study.

In this research due care was taken to avoid the methodological flaws in other studies within the time scale available. The empirical study relied on primary data collected through a field survey in the form of direct interviews, which was carried out by the researcher, with existing formal borrowers and informal borrowers. The survey uses a cross-sectional design that collects information at one point in time supplemented with longitudinal questions. The questionnaire was divided into four main parts. The same set of questions was asked to the two groups. The questionnaire was prepared taking into consideration that the comparison group is not there merely to act as a comparison group; the fact is that it is also an interesting group in its own right.

It can be concluded with a high level of confidence that the data collected from the microenterprise sector proved to be as reliable as any data collected from an audited financial information, as the necessary procedures and due care were taken, and the different barriers were resolved to give this study more reliable data.

Chapter Five: The Sample Characteristics and Analysis

5.1 Introduction

After highlighting the methodological approach adopted in this study in the previous chapter, this chapter presents an overview of the sampled microenterprises and a picture of the main features, background, and characteristics of their owners. Furthermore, this chapter highlights the characteristics of the microenterprises and their owners that might have an impact on their choice of dealing with formal or informal sources of finance. The individual characteristics and attitudes of MSEs are very important factors in the determination of the finance sources but are often neglected in research (Cosh and Hughes 1994; Read 1998). Characteristics such as personality, background, education, and experience all impinge on the financial decisions made by the microenterprise owner. Hence, in this study respondents are grouped according to their dealings with finance sources, i.e. formal borrowers and informal borrowers, in order to highlight the difference that might exist between the two groups, and to segregate the socio-economic and financial factors that might determine the finance source. The two groups were chosen because they had almost identical characteristics, and, as mentioned in chapter four, the comparison group is not there merely to act as a comparison group, the fact is that it is also an interesting group in its own right.

Hence, the first section in this chapter describes the characteristics of the microenterprise owners. The second section explores and analyses the sampled microenterprises' characteristics. The third section describes the use of the different financial resources through the microenterprises' different life stages. The fourth section describes the overall financial performance of the microenterprises sampled. The fifth section describes the personal perceptions or attitudes of the microenterprises owners towards the different finance sources, and this chapter is ended with a summary and conclusions.

5.2 The microenterprises owners' characteristics

This section provides information on the microenterprises owners' (the respondents') backgrounds and personal characteristics including gender, age, marital status, education level, home location, dependency or household size, and monthly income. Table 5.1 provides frequencies and percentages of the microenterprises owners' characteristics. The following could be noticed for each characteristic:

- **Gender.** One can observe that the distribution of male and female are uneven. The representation of female is only 6 percent of the total sample, which may be due to the fact that the sample was selected from an NGO, semi-formal financial institution, where women are still not used to deal with any formal institutions. The area of male gender domination needs further study, but this is out of the scope of this study. Among the relevant studies that can be referred to in this area is a study by Read (1998) on the difference between the male and female microenterprises domination with regard to access to finance.
- **Owners' ages.** The majority of the respondents belong to the age group ranging between 26-35 years old. Both groups almost have the same mean; 37 for the first group, the formal borrowers, and 36 for the second group, the informal borrowers, with a standard deviation of 8.87 and 7.6 respectively. This, relatively, low average age level could be explained by the fact that most of the owners are relatively new entrants, which contradicts findings of several other studies e.g. El-Mahdi and Powell (1999), where they claim that there is a tendency towards concentration of microentrepreneurs in higher age levels.

- **Marital status.** The majority of both groups were married, which reflects the Egyptian culture that has a tendency towards early marriages.

Table 5.1: The microenterprises owners' characteristics.

Variables	Attributes	Formal Borrowers		Informal Borrowers		Total	
		Frequency	%	Frequency	%	Frequency	%
Gender	Female	4	8.0	2	4.4	6	6.3
	Male	46	92.0	43	95.6	89	93.7
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Owners' age	Under 25	4	8.0	1	2.2	5	5.3
	26 to 35	21	42.0	22	48.9	43	45.3
	36 to 45	15	30.0	16	35.6	31	32.6
	Over 46	10	20.0	6	13.3	16	16.8
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Marital status	Married	32	64.0	37	82.2	69	72.6
	Single	17	34.0	8	17.8	25	26.3
	Widowed	1	2.0	0	0	1	1.1
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Educational level	Illiterate	1	2.0	0	0	1	1.1
	Read & write	2	4.0	5	11.1	7	7.4
	Primary & Preparatory	4	8.0	1	2.2	5	5.2
	Secondary	3	6.0	3	6.7	6	6.3
	Intermediary	16	32.0	13	28.9	29	30.5
	University	24	48.0	23	51.1	47	49.5
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Home location	Less than 1 km	14	28.0	13	28.9	27	28.4
	1 to 2.99 km	18	36.0	15	33.3	33	34.7
	3 to 5 Km	8	16.0	5	11.1	13	13.7
	More than 5 km	10	20.0	12	26.7	22	23.2
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Dependency ratio	None	13	26.0	8	17.8	21	22.1
	One person	5	10.0	6	13.3	11	11.6
	Two persons	3	6.0	5	11.1	8	8.4
	Three persons	9	18.0	8	17.8	17	17.9
	Four persons	12	24.0	9	20.0	21	22.1
	Five persons	4	8.0	7	15.5	11	11.6
	More than six	4	8.0	2	4.4	6	6.3
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Other businesses the owners own or mange	None	39	78.0	38	84.4	77	81.0
	Another one	8	16.0	7	15.6	15	15.8
	More than one	3	6.0	0	0	3	3.2
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Religion	Christian	27	54.0	11	24.4	38	40.0
	Muslim	23	46.0	34	75.6	57	60.0
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Monthly income	500 or less	2	4.0	3	6.7	5	5.3
	501- 600	2	4.0	4	8.9	6	6.3
	601- 700	5	10.0	5	11.1	10	10.5
	More than 700	41	82.0	33	73.3	74	77.9
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

- **Educational level.** The respondents as a whole were well educated. Almost 50 percent were university graduates and 30 percent had already finished high school diplomas. This high level of education found in this sample indicates the high degree to which the owner is informed about the different finance sources. This evidence, considered in the light of an overall illiteracy rate of about 35 percent in Egypt, stresses the importance of education in the entrepreneurial decisions. On the other hand, owners with low level of education do not exceed 2 percent of all respondents. Therefore, it is possible to conclude, that the dominant type of owners are well educated and informed of the finance sources available, and can deal easily or possess the skill to deal with the formal financial institutions. On the other hand, this high percent of well educated microenterprise owners could be a reflection of the fact that was mentioned earlier, in chapter three, that 93 percent of the unemployed, as of 1995, are less than 30 years old and most are college and high school graduates (Assaad and Rouchdy 1998).
- **Home location.** It is clear that microenterprise owners choose a work location that is usually not far from their residence. More than 60 percent of the respondents have established their firms close to where they live; it takes them less than 15 minutes to reach their work place.
- **Dependency ratio and household size.** A lot of people were dependent on the earnings of the respondents. Four persons dependent on the microenterprise income was the main response by the two groups. In Egypt, households are nuclear units consisting of the household head, almost always a man, his wife and their children, and it is a very common practice that the grandfather and grandmother live in the same house. As to the overall education level of the respondents' families, the majority send their children to school despite the fact that 40 percent of both groups' children do not go to school yet, which is a reflection of the relatively young age of the respondents of both groups as mentioned earlier.
- **Other business(es) the owners own or manage.** Only 15 percent of the respondents have other businesses that they own or manage, which may include a salaried job, and less than 6 percent have more than 2 businesses. The majority of microenterprise owners have one business only, which is similar to the results of a survey undertaken in urban Cairo by El-Mahdi and Powell (1999). The majority

having one business to run, can be interpreted either that the microenterprises provide sufficient resources so that the individual does not need to work elsewhere, or that it is difficult to have access to other work opportunities. This point will be further discussed in chapter six.

- **Religion.** As previously mentioned in chapter four, the sample may contain a higher percentage of Christians than in other areas, which reflects the nature of the location of the sample. The area has a high concentration of Christians, as they represent over 30 percent of Shubra's population. It could be seen from table 5.1 that the formal borrowers who deal with this Christian NGO are mainly Christians; i.e. 54 percent of the first group. This fact may have a distorting effect on some of the aspects of the data collected, for example, attitudes towards credit, which will be further tested. On the overall, as could be seen from table 5.1, the total Christian percentage is 40 percent, which is very close to the real percentage of Christians in this area.
- **Monthly income.** The monthly income of the microenterprises owners, 82 percent of the formal borrowers and 74 percent of the informal borrowers, were found to be more than 700 Egyptian pounds. Such a monthly income by the Egyptian standards is sufficient for an average family; hence, this study revealed that less than 22 percent of the overall respondents may be considered as poor or would have some difficulty with living expenses if they have a large family; the rest of the study sample is well off.

In addition to the above characteristics, there are three other characteristics, or features, that help in drawing a complete profile of the microenterprises owners. The first characteristic relates to the motives for starting the business. There are two views of the microentrepreneurs' motives to enter into this business sector. The first one, the underemployment view, considers workers in this sector as either underemployed or surplus labour. These workers cannot find a job in the formal sector due to their low skills and general unemployability; i.e. a survival strategy e.g. El-Mahdi and Powell (1999). The second view, on the other hand, the microentrepreneur view, focuses on the fact that some workers choose this sector for its flexibility and earnings opportunities e.g. McMahon et al. (1993). While the existence of high levels of poverty in this business sector is strongly suggested by the first view, poverty is not necessarily a permanent microenterprise condition according to the second view.

In the present study, the microenterprise owners indicated their most important reason for entering into this sector to be that the expected income from self-employment is greater than other jobs; table 5.2 shows it to be 48 and 38 percent respectively for each group. This finding is in line with a similar study undertaken by Elleithy (1996) in Egypt, where he found that the push or the negative factors associated with economic hardships have a limited effect on the establishments of MSEs. Furthermore, he added that positive factors, such as the prospect of good financial income, were the main motives. This finding, also, lends support to the weak relationship found between microenterprise finance and unemployment rates, which will be discussed in more detail in chapter six.

Table 5.2 also reveals that only 20 and 27 percent of each respective group indicated that this was the only occupation available. 20 and 18 percent of each respective group also cited that being independent is of great importance to them, and less than 4 percent said that they entered this field to help with the living expenses as an additional income. Also almost 10 percent of both groups entered into this sector to follow the family tradition or inherited the business from the family.

Table 5.2: Reasons for establishing the microenterprise.

	Formal Borrowers		**Informal Borrowers**		**Total**	
Reasons of Entry	**Frequency**	**%**	**Frequency**	**%**	**Frequency**	**%**
Expected income from self-employment is greater than other jobs.	24	48.0	17	37.8	41	43.2
There was no other employment available	10	20.0	12	26.7	22	23.1
To become self employed and gain more independence	10	20.0	8	17.8	18	19.0
Following family tradition	5	10.0	5	11.1	10	10.5
To improve living conditions (an additional income besides the current job)	1	2.0	3	6.7	4	4.2
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

Comparing these results to similar studies in other developing countries, in Mexico, when microenterprises owners were asked during the National Survey of Microenterprises in 1994 why they started their businesses, about 24 percent of the microenterprises owners said that they became self-employed in order to gain more independence, and 37 percent became entrepreneurs because they expected that the income from self-employment would be greater than the income from a salaried position. Almost 26 percent went into business to complement family income, 10 percent started a business to follow family tradition, and 8 percent became entrepreneurs because there were no other employment opportunities available (Heino and Pagán 2001). These results are similar to this study. However, on the other hand in a similar study in Kenya by Daniels et al. (1995) the largest proportion of respondents, 31.2 percent, reported that they wanted to supplement their income, and 26 percent mentioned that they had no better options, while 23 percent felt that a small business would provide more income and the rest preferred to have more independence. This vast contrast between one country and another indicates how difficult it is in this field of research to compare this sector of business across countries, even though they are all developing countries. This reflects the fact that generalisations of results or copying policies form one country to another without thorough study are inappropriate.

Another interesting observation is that when comparing the motives or reasons for entering into this sector with the average annual growth rate of the sampled microenterprises, after adjusting for inflation, as shown in figure 5.1, the higher average growth rates are within the microenterprises that stated that their motives for starting the business is that the expected income from the business is greater than from other jobs.

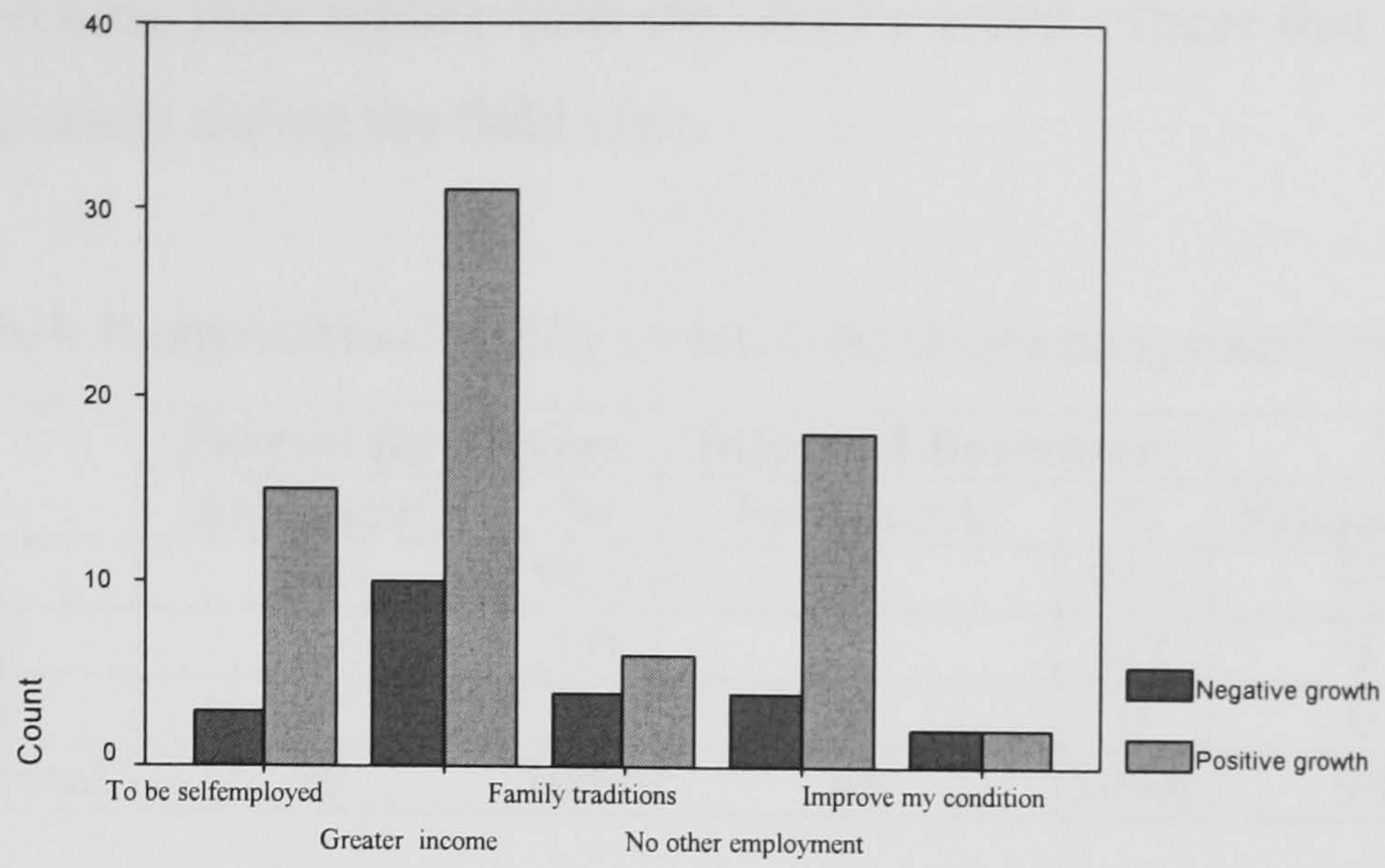

Figure 5.1: Comparison of average growth rate with business motives.

The second characteristic relates to the personal attitude or consideration of the owners in deciding to undertake this type of activity. Microenterprises' owners were asked to indicate the most important factor they considered when deciding to undertake a new business. The results are summarised in table 5.3 which shows that the familiarity with the work is not a very important factor, and that the main consideration is always how far the business is profitable. As for the capital required, it was the second factor in frequency and not the major one; this phenomenon will be discussed in further details in section 5.6.3.

Table 5.3: The most important factor considered for undertaking a new business.

Most important factor for undertaking a new business	**Formal Borrowers**		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Work that seems profitable	16	32.0	18	40.0	34	35.8
The capital required	13	26.0	12	26.7	25	26.3
The season/ market demand	13	26.0	3	6.7	16	16.8
Work I am familiar with	5	10.0	8	17.8	13	13.7
What others are doing	3	6.0	2	4.4	5	5.3
Work I can do and still take care of my family	0	0	2	4.4	2	2.1
Total	**50**	**100**	**45**	**100**	**95**	**100**

The third characteristic is the overall awareness of the microenterprises owners of the enterprises' profitability. This study revealed that despite the fact that the majority do not maintain any type of records, they are very much aware of the financial aspects and they know very well the value of their goods and the most profitable items. Table 5.4 shows that 95% found no difficulty in estimating their profit. The answer to this question was gleaned from the way the respondents answered the questions, and by cross checking their replies with the NGO's credit officer that accompanied the author of this study during the field visit.

Table 5.4: Respondents' ability to estimate their enterprises' profit.

	Formal Borrowers		Informal Borrowers		Total	
Ability	**Frequency**	**%**	**Frequency**	**%**	**Frequency**	**%**
No difficulty	48	96.0	42	93.3	90	94.7
Some difficulty	2	4.0	3	6.7	5	5.3
Great difficulty	0	0	0	0	0	0
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

This descriptive section revealed interesting trends that might influence financial behaviour. The percentage of formal borrowers, who are single 34 percent, is almost double than the informal borrowers, 17 percent. This could be interpreted as a trend that the owners establish themselves first before going into any form of marital engagement; hence they may use all of the available finance sources, formal and informal, to reach their aims as quickly as possible. The formal borrowers, 22 percent, and the informal borrowers, 17 percent, often run more than one business. This could be a reflection of the attitude towards the diversification of investment and the trend towards a more entrepreneurial attitude, which is searching for different and more forms of finance sources. The formal borrowers group is of a more opportunistic nature as 13 percent of them, compared to only 3 percent of the informal borrowers group, mentioned that whatever is in demand, or whatever the market needs, they will supply. Also the formal borrowers who have monthly income above 700 Egyptian pounds were 82 percent, as opposed to the informal borrowers 74 percent. This could have several interpretations, either from the supply side perspective where the financial institutions tend to lend more to microenterprises with higher income, or from the demand side perspective that people with lower income are afraid from repayments problems and often do not want to have more debt. Those four interesting trends will be further investigated and analysed in the following sections and in the next chapter. In general, with the exception of the above mentioned trends, the personal characteristics of the microenterprises' owners on which the two groups were compared are similar, and the overall systematic differences between the two groups that might influence the finance decision are negligible.

5.3 The microenterprises' characteristics

This section begins by highlighting the general characteristics of the microenterprises, and then attempts to distinguish between the microenterprises that have a growth potential and the extent of formality of the sampled microenterprises.

5.3.1 The general characteristics

This section provides information on the microenterprises' characteristics upon which the two groups were compared: business age, business type, ownership structure, number of workers, working hours, annual turnover and fixed assets. Table 5.5 provides frequencies and percentages of the two groups for the microenterprises sampled.

- **Microenterprise's age.** Despite the effort to make the gap difference in the age of the microenterprises establishment between the two groups not to exceed 3 years, the microenterprise age among the formal borrowers group, as shown in table 5.5, is slightly higher. The overall mean is comparable except for the microenterprises established before 1960, which are only 20 percent of the sample. The mean for the formal group is 13.06 with a standard deviation of 12.96, and for the informal borrowers group is 10.40 with a standard deviation of 9.50. This slightly higher mean in favour of the formal borrowers group may be interpreted as the older the enterprise is, the more easily it could obtain formal loans. The overall microenterprises ages included in the study were relatively young, as 63 percent were under 10 years old. The majority of the microenterprises were between the ages of 3 to 5 years old, 31 percent. While the ages of the microenterprises in this study were younger than those in other studies of MSEs, the age trends do reflect the way in which the sample was selected. In this research using an NGO database as the base, the sample may have been biased towards older enterprises as there were no new start-ups.
- **Business sector.** There is a predominance of the trading sector and a minority from the service and manufacturing sectors. As shown in table 5.5, most of the sample is from the trading sector, 46 percent; this finding may be the result that this sector is more appealing to lenders especially the formal lenders. Also, this sector dominance may be due to the way in which samples

Table 5.5: The microenterprises' general characteristics.

Variables	Attributes	Formal Borrowers		Informal Borrowers		Total	
		Frequency	%	Frequency	%	Frequency	%
Microenterprise Age	Up to 2 years	7	14.0	1	2.2	8	8.4
	3 to 5 years	11	22.0	18	40.0	29	30.5
	6 to 10 years	12	24.0	11	24.4	23	24.2
	11 to 19 years	9	18.0	8	17.8	17	17.9
	20 years or more	11	22.0	7	15.6	18	19.0
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Business sector/activity	Trading	24	48.0	22	48.9	46	48.4
	Trading & Services	11	22.0	11	24.4	22	23.2
	Manufacturing	11	22.0	9	20.0	20	21.0
	Services	4	8.0	3	6.7	7	7.4
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Ownership structure	Sole proprietorship	18	36.0	27	60.0	45	47.4
	Family partnership	28	56.0	14	31.1	42	44.2
	Non-family partnership	2	4.0	4	8.9	6	6.3
	Limited liability company	2	4.0	0	0.0	2	2.1
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Number of workers	None	4	8.0	1	2.2	5	5.3
	One worker	11	22.0	6	13.3	17	17.9
	Two workers	17	34.0	19	42.2	36	37.9
	Three workers	6	12.0	9	20.0	15	15.8
	Four workers	5	10.0	6	13.3	11	11.5
	Five workers	4	8.0	2	4.4	6	6.3
	Six workers	3	6.0	2	4.4	5	5.3
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Annual turnover	Less than 24,999	8	16.0	12	26.7	20	21.1
	25,000 - 74,999	18	36.0	16	35.6	34	35.8
	75,000 – 149,999	15	30.0	12	26.7	27	28.4
	150,000 – 299,999	7	14.0	3	6.7	10	10.5
	300,000 and over	2	4.0	2	4.4	4	4.2
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Weekly working Hours	Under 45	1	2.0	1	2.2	2	2.1
	46-66	16	32.0	14	31.1	30	31.6
	Over 67	33	66.0	30	66.7	63	66.3
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Fixed assets groups	Less than 5,000	4	8.0	15	33.3	19	20.0
	5,000 to 10,000	9	18.0	2	4.4	11	11.6
	10,001 to 20,000	12	24.0	15	33.3	27	28.4
	20,001 to 40,000	10	20.0	7	15.6	17	17.9
	Above 40,000	15	30.0	6	13.3	21	22.1
	Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

were selected. On the other hand, this finding is in line with the common perception that microenterprises are primarily vendors and small traders, and that the majority are engaged in trading activities e.g. El-Mahdi and Powell (1999). It should also be noted that most of the manufacturing sector is an apprentices sector, which is mainly a tiny workshop like welding and metal works, small cloth factory shops, and furniture-wood processing. As for the service sector, it was 7 percent only of the total sample as the need for capital by this sector is not always essential like the other sectors. This service sector was mainly personal or household services such as electricians, tailors, mechanics, shoe repairers, and photographers.

- **Ownership structure.** As mentioned by Mead and Liedholm (1998), self employment is a central element in such economies. The majority of both groups were sole proprietorship or family partnership. Sole proprietorship constituted the main type of firms, 36 percent of formal borrowers, and 60 percent of the informal borrowers, followed by the family partnership, 56 percent and 31 respectively, which reflects the family nature of this sector. Non-family partnerships were 4 and 10 percent respectively. There is an interesting finding from this comparison as 60 percent of the formal borrowers group are in partnership, whether from the family or outside, and only 40 percent of the respondents in the informal borrowers group are in a partnership of any type. It should be noted that a lot of respondents do not consider family partners as outsider equity especially that the majority of partners are usually form the very close relatives i.e. father or brothers.
- **Number of workers.** The majority of the microenterprises consist of two persons working or less, 38 percent; none and less than two workers is 23 percent. The mean number of employees is comparable in the two groups. For the formal borrowers group it is 2.4, and for the informal borrowers group it is 2.6, with a standard deviation of 1.6174 and 1.3212 respectively. Microenterprise employment is generally restricted to the owners and members of their families. As could be seen from table 5.6, more than 54 percent of the sample has more than 50 percent of their employees from their family members.

Table 5.6: Number of family members employees.

Family Members Employees	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Non-family members	15	30.0	18	40.0	33	34.7
All are family members	20	40.0	5	11.1	25	26.3
50 percent or more	10	20.0	16	35.6	26	27.4
Less than 50 percent	5	10.0	6	13.3	11	11.6
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

- **Annual turnover.** The majority of all microenterprises in this study had an annual turnover of less than 150,000 Egyptian pounds. At the other extreme, just 4 percent had a turnover in excess of 300,000 Egyptian pounds. What was also noticed is that the informal borrowers tend to have lower turnover than the formal borrowers. One possible reason for this is that the formal borrowers choose a high growth strategy by taking out more loans from any source to increase their turnover and gain more money. On the other hand, as shown in figure 5.2, there is a trend towards a positive relation between the total sales and the total amount borrowed for the formal borrowers group. Where as for the informal borrowers group, as shown in figure 5.3, the total amount borrowed is not affected by the total sales. It can be concluded that the informal lending is not directly related to the total sales, or in other words the sales figure is not among the determining factors that decide on granting, and value of, the loans in the informal finance sector.

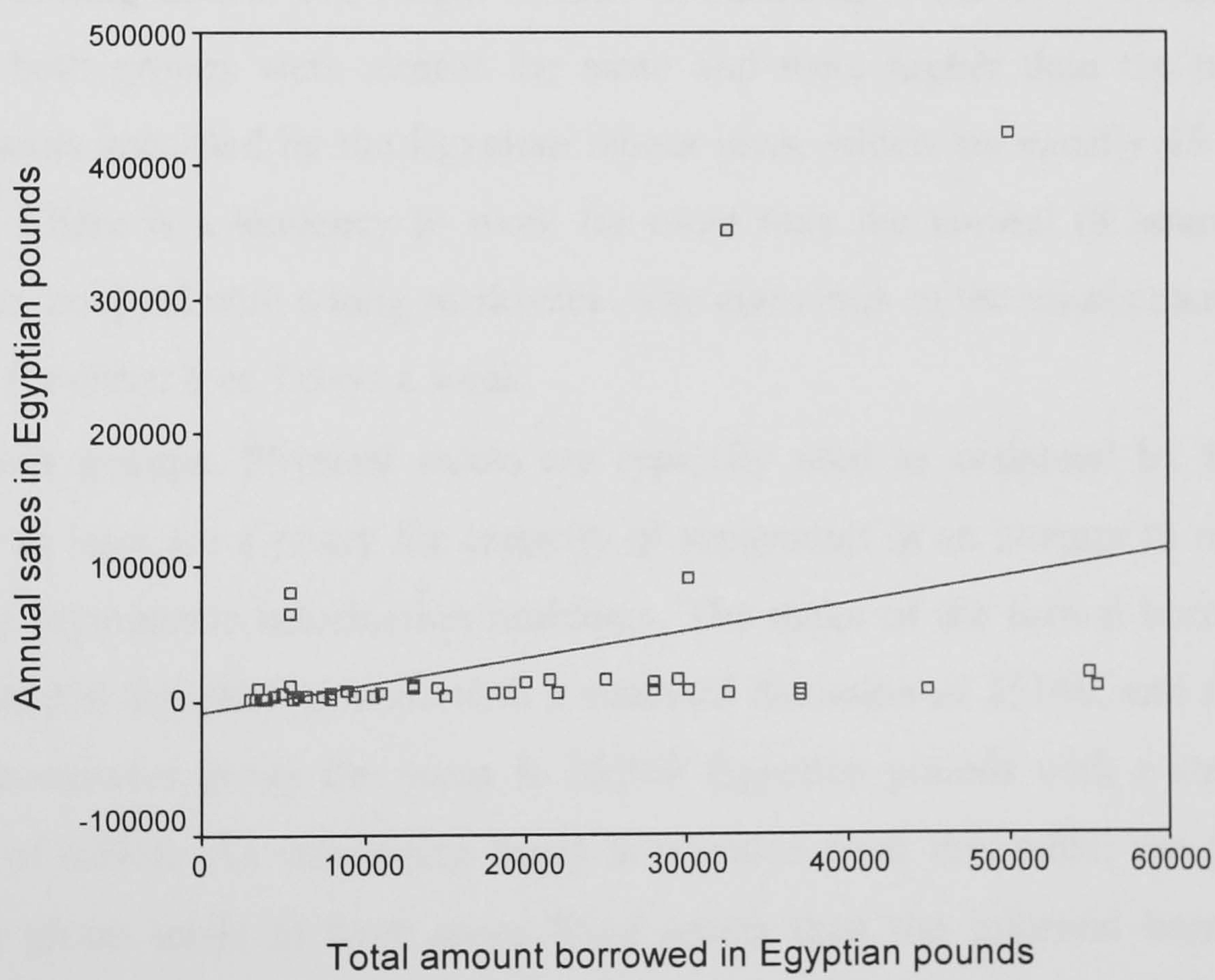

Figure 5.2: Formal borrowers group's annual sales vs. total amount borrowed.

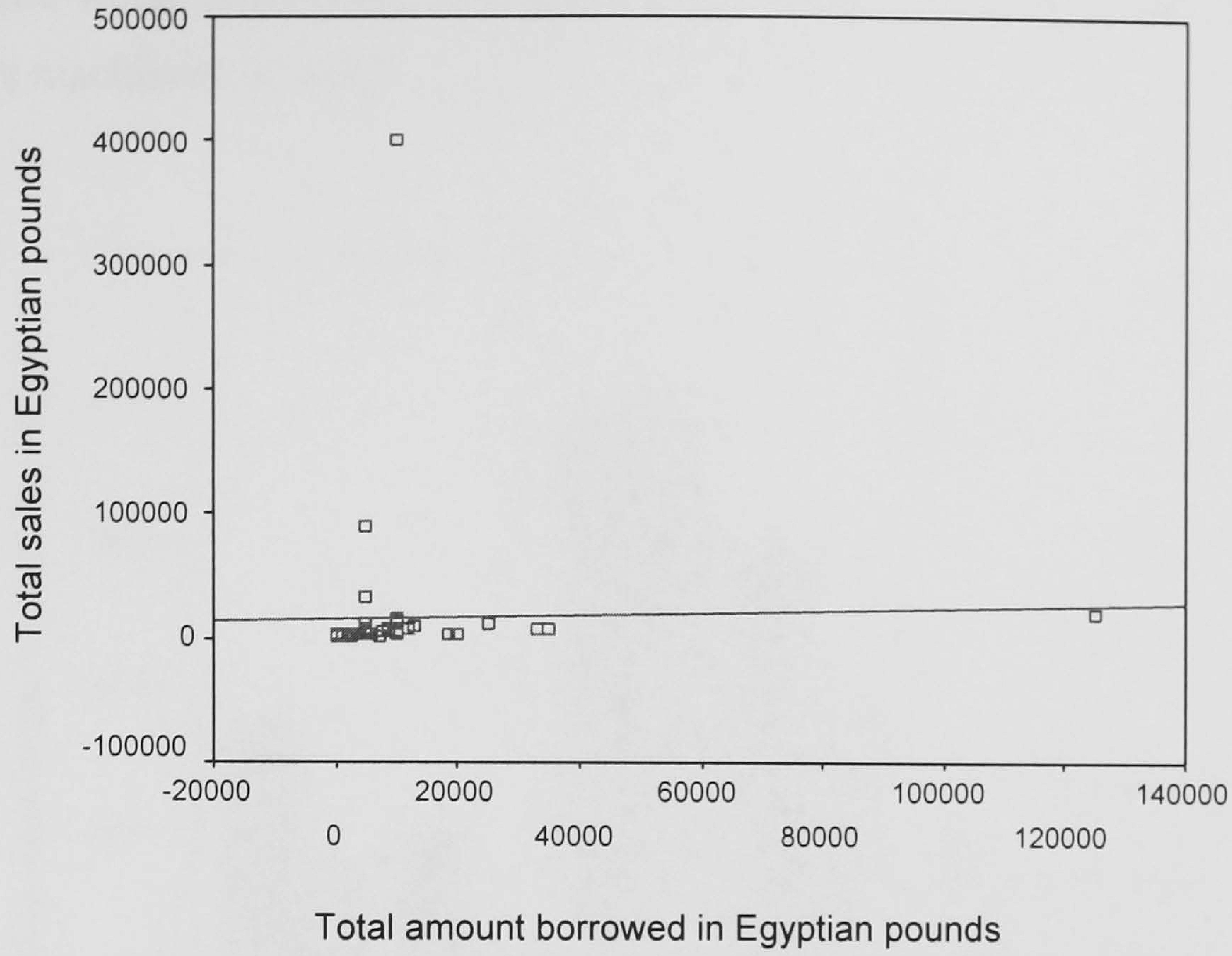

Figure 5.3: Informal borrowers group's annual sales vs. total amount borrowed.

- **Weekly working hours.** The length of time in business, or the hours worked per week, by both groups were almost the same and were higher than the normal working hours specified by the Egyptian labour laws, which are usually 45 hours per week. There is a tendency to work for more than the normal (8 hours/day) work hours, coupled with a long workweek. The main bulk of the microenterprises are active for either 6 or 7 days a week.
- **Fixed assets groups.** Physical assets are typically used as collateral by formal lenders or at least are a proxy for capacity of repayment in an attempt to resolve part of the asymmetric information problems. The mean of the formal borrowers group is 30,050 Egyptian pounds with a standard deviation of 25140, and for the informal borrowers group the mean is 26,389 Egyptian pounds with a standard deviation of 43960. An interesting trend is revealed from this table; the formal borrowers group tends to have more fixed assets than the informal borrowers group. The average value of physical assets, excluding land and building, as expected, varied significantly by sector. As shown in figure 5.4, the trading activities have the highest value of fixed assets when compared to the manufacturing activities. This is mainly, as mentioned earlier, due to the fact that the manufacturing enterprises in this sector are an apprentices sector, which is mainly a tiny work shop like welding and metal works, small cloth factory shops,

or furniture-wood processing, which relies on labour skills and does not have expensive machinery or tools.

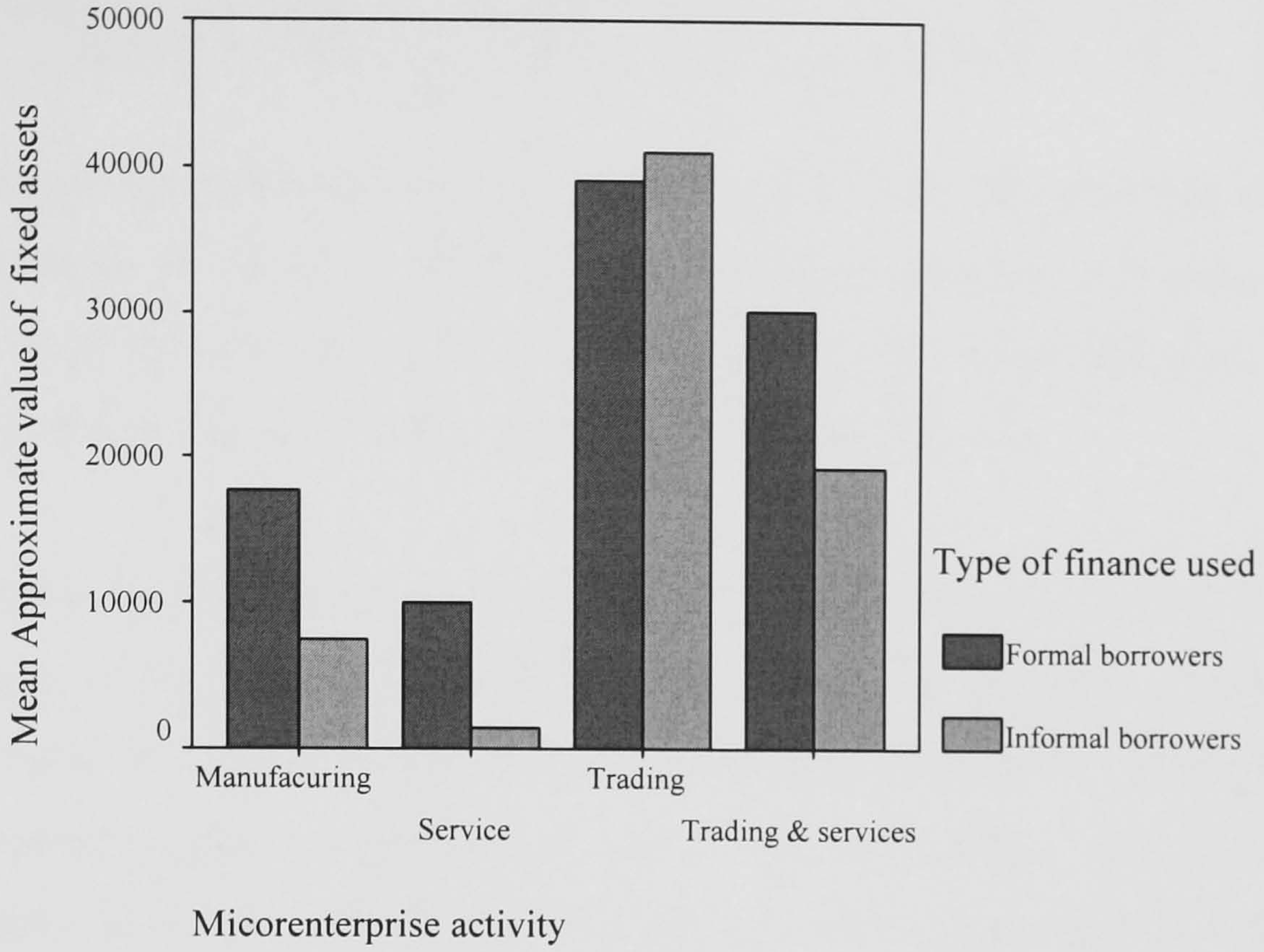

Figure 5.4: Distribution of fixed assets value by microenterprise activity.

5.3.2 Growth potential

The microenterprise sector is characterised by a duality in its growth pattern. Some enterprises are small because of the nature of the activity undertaken. The type of industry in which they operate dictates that small enterprises are more effective and efficient than larger firms; therefore, their prospects for growth are limited. Other enterprises are small because they are new enterprises and they may have the potential to become large enterprises. The latter enterprises are dynamic and responsive to economic stimulus and have the potential to grow (McMahon et al. 1993). Based on the above views the sampled microenterprises were classified into two groups based on the real growth of the capital invested, where the current capital is adjusted for inflation by using the consumer price index. Table 5.7 shows the results of this classification, where 24 percent of the respondents have negative growth and only 76 percent experience sustained growth.

Table 5.7: Microenterprise with positive growth.

Growth	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Negative growth	10	20.0	13	28.9	23	24.2
Positive growth	40	80.0	32	71.1	72	75.8
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

Table 5.7 reveals an interesting finding, despite the fact that this sector has very high profit percentages as shown in table 5.22; income generated by this sector is not always put back into the business i.e. used to increase the microenterprise capital, which will be further investigated in the next chapter, chapter six.

Despite the fact that the data was not collected over different periods of time, the different ages of the microenterprises provide a basis for identifying changes in trends over time. This trend reveals that the general growth pattern of the majority of the microenterprises grows significantly only at the beginning of their operations, and then almost levels out, or maintain the operations at a constant level as shown in figure 5.5. The average mean of the annual growth is very high in the early 3-4 years of a microenterprise's life, then starting from the 8^{th}-9^{th} year it is almost constant, or even negative in some instances, over the rest of a microenterprise's life. Furthermore, the relationship between the annual growth rate, after inflation, and a microenterprise's age was investigated using Pearson's product-moment correlation coefficient. There was a moderate negative correlation between the two variables ($r=-0.399$, $n=95$, $p<0.005$); the younger the microenterprise the higher the rate of growth. This interesting result is due to the fact that the majority of the microenterprises grow only at early stages of the business and then level out, or maintain their operations at a constant level. This is in line with similar results reported in different countries, e.g. Cabal and Parker in Mead and Liedholm (1998), Baydas et al. (1997b), and a USAID study in seven different countries by Sebstad and Chen (1996), which all show an inverse relationship between microenterprise expansion and the age of the enterprise. The younger the microenterprise is, the more likely that it shows higher rates of growth. These studies found that most of the expansion occurred in the first two years. They also found that after the eighth year there is a common pattern of downsizing among microenterprises of all types and sizes.

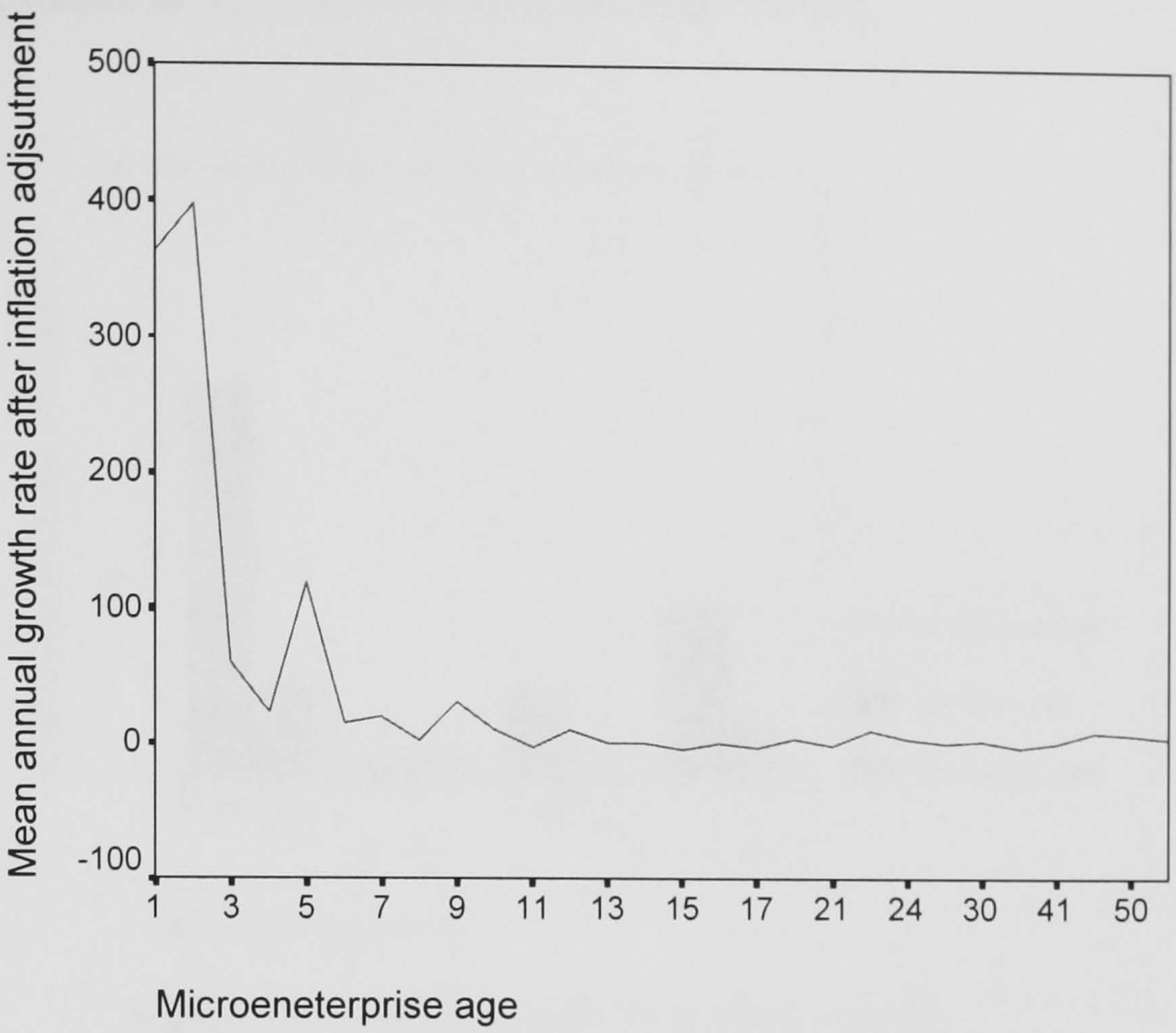

Figure 5.5: Mean annual growth rate after inflation.

The overall means of the growth rate for the two groups since inception are shown in table 5.8. After adjusting for the extreme values the mean is 50 percent for the formal borrowers with a standard deviation of 74, and 20.2 percent for the informal borrowers with a standard deviation of 43.

Table 5.8: Annual growth rate after inflation classified by type of activity.

Activity	Formal borrowers			Informal Borrowers			Total		
	n	Mean	Std. Deviation	n	Mean	Std. Deviation	n	Mean	Std. Deviation
Manufacturing	11	149.7	340.1	9	37.1	106.2	20	99.0	262.5
Service	4	8.5	10.4	3	14.3	25.8	7	10.9	16.9
Trading	24	42.8	59.6	22	13.6	20.3	46	28.9	47.1
Trading & services	11	77.6	111.6	11	30.5	46.1	22	54.1	86.7
Total	**50**	**69.6**	**130.4**	**45**	**23.9**	**49.6**	**95**	**48.2**	**103.3**

By comparing the growth of the different sectors, as shown in figure 5.6, it is revealed that the manufacturing sector has the highest growth rate, and that the formal borrowers, in general, have higher growth rates than informal borrowers, which may be a reflection of the attitude of the formal borrowers in borrowing from any available source to reinvest in the available opportunities.

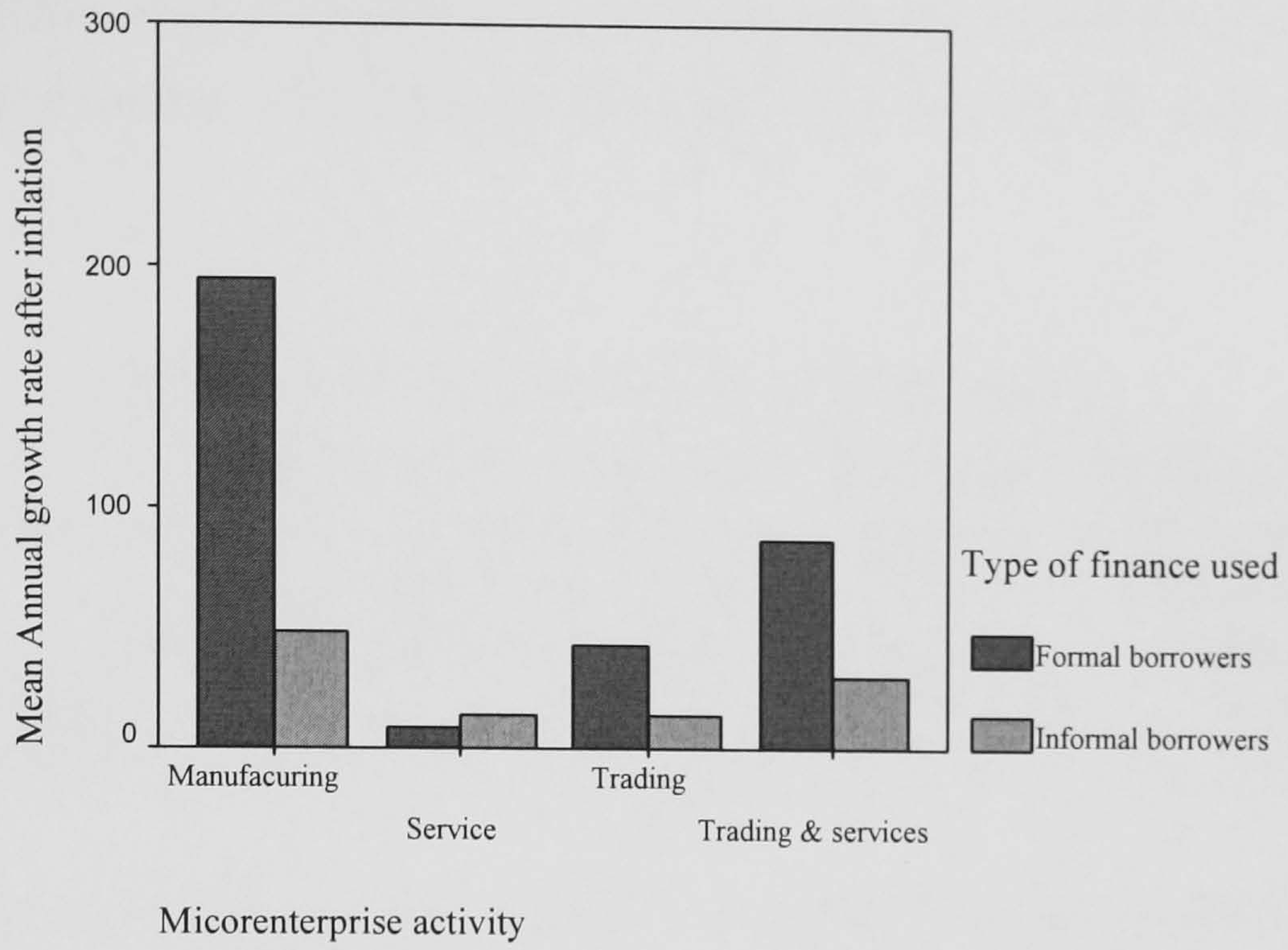

Figure 5.6: Annual growth by type of activity.

The above discussion reveals that it is difficult to apply Hutchinson and Rays' financial life cycle of small growth enterprises, relating to the stages of development, discussed in chapter two. This financial life cycle of the enterprise, which is referred to in some of the literature as Evans' hypothesis, suggests that the financial life cycle passes through at least three stages of growth; each stage has different types of financing from different sources, as illustrated in table 2.1. These various types of financing are not all utilised at once when the business is established; they evolve as the firm grows and develops. On the contrary, the above section reveals that this sector does not pass through the same three stages of growth. What is noticed is that this sector is categorised with a very short growth cycle and that microenterprises reach maturity very quickly.

5.3.3 Informality of the business sector

Microenterprises can also be classified into two groups based on the extent of the formality as per the criteria specified in chapter one. This criterion was based on asking four questions to decide the level to which a microenterprise belongs to the formal or informal sectors. The four questions were to be answered with "yes"; if one question was answered with "no" then the microenterprise is considered as part of the informal sector. The respondents' results shown in table 5.9 reveal that the microenterprise sector is not homogenous with respect to its compliance with the law. More often, written records do not exist nor do microenterprises owners separate family expenses from business accounts; such deficiencies make them non-bankable.

Table 5.9: Microenterprise extent of formality.

Type of finance used	**Do not keep the enterprise money separate from household expenses**	**Calculate profit based on written records**	**Pay taxes based on written records**	**The firm registered with the authorities (Administration registration)**
Formal borrowers	62.0%	14.0%	4.0%	94.0%
Informal borrowers	48.9%	13.3%	4.7%	93.3%

This grouping or classification revealed an interesting observation. Out of the total sample, only three microenterprises could be considered among the formal sector based on the operational definition highlighted in chapter one. This means, as shown in table 5.10, that about 97 percent of the microenterprises sampled are being classified as part of the informal sector. Furthermore, with regard to keeping the enterprise money separate, the formal borrowers' group replies showed less conformity with this condition, where the reverse result would have been expected.

Table 5.10: Classification of the microenterprises to formal or informal.

	Formal Borrowers		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Informal sector	49	98.0	43	95.6	92	96.8
Formal sector	1	2.0	2	4.4	3	3.2
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

From the above two tables, it can be concluded that despite the fact that the majority of the respondents' enterprises were registered businesses with trading licences, administration registration, the majority belong to the informal sector as they do not pay taxes based on proper written records. As mentioned by Mead and Morrisson (1996), it is clear that being registered is neither a necessary nor a sufficient condition for payments of taxes. A definition of informality based on registration would only give a very imprecise indication of the likelihood that the enterprise would pay any taxes other than the registration fees.

5.4 Diversity of the finance sources available

Finance can be incurred from a number of sources, which are generally classified as either formal or informal sources. Some researchers divide the supply of funds for enterprises into internal and external sources, when describing how microenterprises finance their operations e.g. Baydas and Graham (1995), Baydas et al. (1997b), Read (1998), and Howorth (1999). Other researchers, e.g. Adams and Fitchett (1992), prefer to think of finance sources as existing on a continuum, rather than being divided clearly into two distinct categories, that ranges from casual loans among friends and relatives to formal finance that are closely regulated by a central bank. In this research the latter definition is followed, as previously discussed in chapter three. In this section an attempt to discover if the two respondents groups exhibit significant differences in the financing sources, and the financial constraints faced during the different stages of a microenterprise's life: starting up and the associated under capitalisation problem, financing of current operations or working capital and the associated liquidity constraint, and financing of the future investment.

5.4.1 Financing the start-up of the microenterprise

The majority of the respondents in this survey started their enterprises with very modest amounts of capital. The frequency distribution of start-up costs, as given in table 5.11, indicate that the majority of the microenterprises, 66 percent, have started with less than 10,000 Egyptian pounds, and that the amount which was most frequently used was less than 1,000 Egyptian pounds, which is a negligible amount of capital. Only 16 percent of the total respondents have used more than 20,000 Egyptian pounds. This modest amount of starting capital is a clear reflection of the small-scale nature of the enterprises in this study, which is similar to the results reached by other researchers, notably El-Mahdi and Powell (1999), in urban microenterprises. This result is also inline with similar studies in other developing countries, e.g. a study by Daniels et al. (1995) in Kenya, which found that about 45 percent started with less than 100 Egyptians pounds. Table 5.11 shows an interesting finding that there is not much difference between the formal and the informal groups with regard to the starting capital.

Table 5.11: The frequency distribution of start-up capital.

Amount in L.E.	Formal Borrowers Frequency	%	Informal Borrowers Frequency	%	Total Frequency	%
Under 1,000	15	30.0	9	20.0	24	25.3
1,000 – 4,999	10	20.0	8	17.8	18	19.0
5,000 – 9,999	10	20.0	11	24.4	21	22.1
10,000-20,000	7	14.0	9	20.0	16	16.8
Over 20,000	8	16.0	8	17.8	16	16.8
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

The microenterprises owners managed to use various alternative approaches mainly to substitute for this small starting up capital, as shown in table 5.12, which is known in the literature as bootstrapping. This technique is not confined to small or microenterprises. Over 80 percent of the businesses in a sample from a study in 1989, including the fastest growing 500 private companies in the USA, were started using bootstrapping techniques. The financial bootstrapping technique, or behaviour, refers to the use of different methods for minimising and eliminating the need for financial means for resource acquisition (Winborg and Landstro 2001). For example, some of the respondents, as shown in table 5.12, managed to acquire goods on credit. Table 5.12 reveals the important sources of start-up capital identified by the respondents in this survey, where the majority of the microenterprises have been financed using internal sources at start-up. More than 80 percent of all of the respondents mentioned that funds were generated internally by owners, and that family savings were the major source of finance. The next most important source of finance, after personal/family savings, was found to be supplier credit, which more than 32 percent of the respondents use. Partnership from outside the family represents 20 percent for the formal borrowers, and 11 percent for informal borrowers. At start-up, banks, formal financial institutions, NGOs, or semi formal institutions did not provide any type of finance. These findings of start-up capital sources are in line with similar studies carried out in other countries, e.g. a study by Buckley (1997) in Kenya. Even in a study in the UK, which is a developed country, informal finance was relatively significant at the start-up stage (Cosh and Hughes 1994). Table 5.12 also reveals that the microenterprise owners used multiple sources of finance as will be discussed later; however, there was virtually no significant difference between the number of finance sources used by both groups, 99 and 91 sources of finance used by the formal borrowers and the informal borrowers respectively at the start-up stage.

Table 5.12: Starting capital sources.

Source	Total		Formal borrowers		Informal Borrowers		Sig. X2
	n	%	n	%	n	%	
Internal							
Personal savings	79	83.2	44	88.0	35	77.8	None
Inheritance, family and friends	20	21.1	9	9.5	11	24.4	None
Family partnership	19	20.0	11	22.0	9	20.0	None
Working abroad (in the gulf)	11	11.6	3	6.0	8	17.8	None
External							
Supplier/trade credit	30	31.6	16	32.0	14	31.1	None
RoSCAs (*Gam'iya*)	11	11.6	6	12.0	5	11.1	None
Partnership from outside the family	11	11.6	4	8.0	6	13.3	None
Money lender	5	5.3	3	6.0	2	4.4	NA
Customer advances	3	3.2	2	4.0	1	2.2	NA
NGO's loan	1	1.1	1	2.0	0	0	NA
Commercial banks	0	0	0	0	0	0	-
Total sources used	**190**		**99**		**91**		
Total respondents	**95**		**50**		**45**		

NA: it was not possible to test the statistical significance of these differences, because in order to perform a chi-square analysis, the lowest expected frequency in any cell should be 5 or more

By using a chi-square analysis to test for any statistical significant differences for the start-up capital sources between the two groups, table 5.12 revealed that, if applicable, there are no statistically significant differences between the formal borrowers and informal groups with regard to the sources of starting up capital.

Several studies, focusing on small enterprises, e.g. Haidar (1992) and McMahon et al. (1993), found that the under capitalisation problem is experienced by many young enterprises, which tend to experience an irregular demand for their products or services. In the present survey, just less than half of the total sample did not need any more finance. This could be interpreted as an indication that they were not faced with serious problems relating to under capitalisation, as shown in table 5.13. This finding contradicts the finding of several studies, which revealed that under capitalisation problems is a major constraint, e.g. in Read (1998), where Gregg, Carter and Cannon argue that insufficient capital often limits the potential of MSEs to expand and grow, and that the lack of start-up capital is the single, largest constraint on early growth. Even when most respondents felt that they had more than enough finance from internally generated sources, and that the scale of their businesses did not warrant more finance than was available internally, they attributed this to the fact that many respondents may have underestimated their financial needs. Furthermore, some researchers argue that small firms are often found to be suffering from under capitalisation because of the knowledge gap, rather than the finance gap, where microenterprises owners frequently lack the skills to assess adequately their enterprises' financial needs (Read 1998).

In this study these two reasons, underestimation of financial needs or a knowledge gap for the existence of the under capitalisation constraint in the microenterprises sector, could not be substantiated. The high level of university graduates, as shown in table 5.1 and the high ability to estimate the profits accurately, as shown in table 5.4 refute such arguments.

Indeed, 30 percent of the respondents in this study mentioned that the finance sources used as shown in table 5.13, were their only source(s), and only 18 percent felt that they required more capital which they tried to get from other sources but were denied, but, still, this does not provide a strong evidence for the previous allegations.

Table 5.13: The need for additional starting up capital.

	Formal Borrowers		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
There was no need for other sources	22	44.0	25	55.6	47	49.5
This was the only source available, and I do not know of other sources	18	36.0	10	22.2	28	29.5
I was refused by other lenders	8	16.0	9	20.0	17	17.9
Do not know	2	4.0	1	2.2	3	3.2
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

Table 5.13 revealed that 50 percent of the total respondents found that there was no need for other financing sources, i.e. sources available to them, which was mainly trade credit and personal saving (informal finance), shown in table 5.12, as a start up capital was sufficient. Most of the assumptions underlying this under capitalisation problem are based on the fact that the larger the capital the faster the company will

grow, but what most studies do not cover is whether the microenterprise have the necessary managerial skills to mange larger amounts of capital or not? Some researchers e.g. Buckley (1997) and Dichter (1999) argue that the amount of capital the microenterprises owners can raise is in itself a reflection of their ability to mange such a capital. Islam et al. (1994) stated that at the early stage only family members and friends are the most well equipped people to evaluate the character and commitment of the microenterprises owners. From this perspective, people who do not have the ability to raise funds are unlikely to make good entrepreneurs.

On the other hand, this perspective is challenged by the experience of the Grameen Bank, which has succeeded on the idea that every Bangladeshi is a potential entrepreneur. But this opinion is contradicted by their loan methodology, where one of their initial requirements is the formation of a group of five and regular attendance at meetings (Mordouch 2000). A point that is consistent with both positions is that the microenterprises owners have to show commitment before being able to start an activity and being able to attract finance.

Furthermore, the under capitalisation assumptions do not take into consideration the fact that the majority of enterprises in this sector are income generating and not growth enterprises as was discussed in section 5.3.2; this will be discussed further in chapter six.

5.4.2 Financing working capital

Similarly, as in start-up capital, the most commonly used sources of finance were internally generated sources, more than 90 percent of all of the respondents use this source for financing their on going operations, as shown in table 5.14. The most used source was retained earnings, where 90 percent used the enterprises' cash flow generated to finance working capital needs. The second most important source used is trade credit. Trade credit is used by 83 percent of the microenterprises and is widely available through instalments purchases to finance fixed assets needs. This finding is in line with several studies e.g. Islam et al. (1994) and Lamberte (1992), where much of the working capital requirement is financed by trade credit. A RoSCA or *Gam'iya* was the third most widely used channel among the respondents in the sample, 20 percent. Finally, very few microenterprises owners reported using other forms of finance, such as customers' advances and bank loans. Less than 5 percent of the microenterprises had loans from commercial banks.

What was noted, is that despite the fact that moneylenders have a prominent place in the literature on the informal sector finance, and are considered to be a significant source of finance for low income groups in several other countries e.g. Adams and Fitchett (1992) and Seibel (1998c), in this research it was difficult to find them. Moneylenders are not as common in Egypt like as in other countries, such as India or Bangladesh, and the questions had to be rephrased and asked without the word "moneylender"; the researcher had to ask if they do have loans from friends or relatives with predetermined interest. Despite of this rephrasing the reported use of moneylenders was very low, only around 3 percent, which appeared to be a reflection of the fact that moneylenders in the Egyptian culture is still a shameful business and people regard it not as a full time job, but as a way to increase income as was mentioned in detail in chapter three. The sensitive nature of money lending may well imply that more people had used this form of finance than they were willing to admit (Buckley 1997).

Table 5.14: Sources of financing working capital.

	Total		**Formal borrowers**		**Informal Borrowers**		**Sig. X2**
Source	n	%	n	%	n	%	
Internal							
Retained earnings	85	89.5	43	86.0	42	93.3	None
Relatives and friends with/ without interest	6	6.3	5	10.0	1	2.2	None
External							
Supplier/ trade credit	79	83.2	45	90.0	34	75.6	None
NGOs	50	52.6	50	100.0	0	0	b
RoSCAs	18	19.4	10	20.0	8	18.6	None
Getting a partner	6	6.3	2	4.0	4	8.9	NA
Customer advances	5	5.5	3	6.3	2	4.7	NA
Commercial banks	5	5.3	3	6	2	4.4	NA
Money lender/Pawnbroker	3	3.2	1	2.0	2	4.5	NA
Total sources used	**257**		**162**		**95**		
Total respondents	**95**		**50**		**45**		

NA: It was not possible to test the statistical significance of these differences, because in order to perform a chi-square analysis, the lowest expected frequency in any cell should be 5 or more.

b: There is a statistically significant difference between the two groups.

By using a chi-square analysis to test for any statistical significant differences between the two groups, table 5.14 reveals that there are no statistically significant differences between the formal and informal borrowers groups with regard to sources of working capital, except for NGO loans where the formal group sample was selected from an NGO.

The under capitalisation problem, the liquidity constraint or the true need to finance the working capital, is a controversial issue among researchers. Liedholm and Mead (1999) and Baydas et al. (1997b) argue that the need for working capital is lower than the proprietor's perceived demand; the reason is that the working capital shortages are often the symptom of some other problems such as the lack of managerial skill and raw materials delivery. Nevertheless, the lack of access to credit does curtail the exploitation of highly profitable opportunities, and growth of the microenterprise sector could be accelerated if external financing is available. Therefore, the microenterprises owners had to be asked in an indirect way if their income, during the last 12 months, from the microenterprise activities was sufficient to run it and support their families, and, if not, how they dealt with that. Table 5.15 reveals the replies that were given. Only 24 percent, of the total microenterprise owners, felt that their income from the microenterprise is not sufficient and they felt some liquidity constraints; furthermore the informal borrowers group, 27 percent, experienced more liquidity constraints, when compared to the formal borrowers group, 22 percent only. This low percentage, 24 percent, of microenterprises that experience liquidity constraints, asserts the general conclusion that this sector generates enough cash to run their businesses and support their families.

Table 5.15: Was your income from this business sufficient to run your business and support your family?

	Formal Borrowers		**Informal Borrowers**		**Total**	
Answer	**Frequency**	**%**	**Frequency**	**%**	**Frequency**	**%**
No	11	22.0	12	26.7	23	24.2
Yes	39	78.0	33	73.3	72	75.8
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

The group who answered the previous question with "no", in table 5.15, were asked to identify how they close such a gap? Their answer was that this gap is mainly closed through informal borrowings, as shown in table 5.16. 91 percent used RoSCAs, 39 percent had a salaried job as an additional source of income, 30 percent borrowed from relatives and friends, and 22 percent borrowed from moneylenders, informal loans with interest (money lenders and relatives), to close this gap.

Table 5.16: Sources of financing liquidity constraints.

	Formal Borrowers		Informal Borrowers		Total	
Source	**Frequency**	**%**	**Frequency**	**%**	**Frequency**	**%**
Personal saving	0	0	1	8.3	1	4.3
Relatives with interest	2	18.2	1	8.3	3	13.0
Relatives without interest	4	36.4	3	25.0	7	30.4
Money lender/Pawnbroker	1	9.1	1	8.3	2	8.7
Bank/ NGO	0	0	0	0	0	0
RoSCAs	10	90.9	11	91.7	21	91.3
Having a salaried job	3	27.3	6	50.0	9	39.1
Total respondents	**11**		**12**		**23**	
Total sources used	**20**		**23**		**43**	

Comparing the numbers of finance sources used at the start-up of operation and during the operation, tables 5.12 and 5.14 respectively, the early stages of the microenterprises' lives were found to be financed mainly by the owners' initial savings, and as the businesses grow, and become more larger, the possibility of obtaining more credit increases. As an enterprise grows, the borrowing behaviour also begins to change; microenterprises have access to more sources of credit and tend to engage in more borrowing. Table 5.17 shows that the mean for sources used in financing operations increased for both groups, but for formal borrowers the increase was significantly more. This is similar to a study of small businesses by Read (1998), where she found that most enterprises used one or two sources of finance at start-up. This is expected as the need for and access to more diverse sources of finance tend to increase during the later phases of growth and they become more eligible for different types of financing.

Table 5.17: Average number of sources used.

	Formal borrowers		Informal borrowers	
	Mean	**Std. Deviation**	**Mean**	**Std. Deviation**
Number of sources used at start-up	1.9800	1.0200	2.0444	0.8516
Number of sources used to finance current operation	3.1800	0.7197	2.2667	0.8634

At start-up, 26 percent of all of the respondents have used three sources or more. Later during operation, there was a greater diversity of sources used, with 63 percent of the respondents having used three or more sources, as shown in table 5.18. It is clear from table 5.18 that the number of finance sources increase as the finance grows, which is in line with both reputation-based and monopoly-lender theories of firm finance as mentioned in (Fluck et al. 1998). Fluck et al. (1998) argue that as an enterprise grows it develops enough of a reputation that enables it to obtain cheaper sources of external finance or easier access to additional sources of external finance.

Table 5.18: Number of finance sources used to finance start-up and operation.

	Formal borrowers				**Informal borrowers**				**Total**	
Number of sources used	**Start-up**		**Current operation**		**Start-up**		**Current operation**		**Start-up**	**Current operation**
	n	**%**	**n**	**%**	**n**	**%**	**n**	**%**	**%**	**%**
One source	19	38.0	0	0	13	28.9	7	15.5	33.7	6.3
Two sources	19	38.0	7	14.0	19	42.2	21	46.7	40.0	29.5
Three sources	7	14.0	29	58.0	11	24.4	14	31.1	18.9	45.3
Four sources	4	8.0	12	24.0	2	4.4	3	6.7	6.3	15.8
Five sources	1	2.0	2	4.0	0	0	0	0	1.1	2.1
Total	**50**	**100.0**	**50**	**100.0**	**45**	**100.0**	**45**	**100.0**	**100.0**	**100.0**

It was also noticed from tables 5.12 and 5.14 that the microenterprises often choose to borrow simultaneously from a number of both formal and informal sources at the same time. Both groups resort to extensive cross financing of their loans, as found by several studies e.g. Sinha and Matin (1998) and Mohieldin and Wright (2000).

5.4.3 Financing future expansion

By asking the microenterprises owners what their future strategy for their businesses were, almost 47 percent of them said that they would like to enlarge their existing businesses, and 25 percent said that they would maintain the same sizes of their businesses, as shown in table 5.19. Only around 12 percent mentioned that they would enter into a new business, and the rest would either have a bank deposit or invest in land and building.

Table 5.19: Future strategy during the next three years.

Strategy	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Enlarge the size of the enterprise	26	52.0	19	42.2	45	47.4
Maintain the same size	12	24.0	12	26.7	24	25.3
Enter into new business	7	14.0	5	11.1	12	12.6
Open a deposit account	3	6.0	6	13.3	9	9.5
Ownership of land or building	2	4.0	3	6.7	5	5.3
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

By asking the respondents how they planned to finance their future investments (answers given in table 5.20), they replied that the most significant sources for financing future investment would be their own savings, more than 30 percent. Trying to have NGO or bank loans were reported by 25 percent. What was noted from their replies is that having a partner is not among their sources, as only 2 percent mentioned that they might have new partners.

Table 5.20: Financing future expansion.

Source	Formal borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Internal						
Personal savings/retained earrings	17	34.0	14	31.1	31	32.6
Banks/ NGOs loans	17	34.0	7	15.6	24	25.3
Having a partner	1	2.0	1	2.2	2	2.1
RoSCAs	0	0	3	6.7	3	3.2
Total	**35**	**70.0**	**25**	**55.6**	**60**	**63.2**
Do not know/ have not replied	15	30.0	20	44.4	35	36.8
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

Furthermore, the high percentage of non-respondents indicates that there is no clear vision for financing future operation, and they are not interested in future expansion. Contrary to some expectations, a lack of loans is not the binding constraint that limits the expansion of microenterprise. Many microenterprises owners do not have the will to grow, as shown in table 5.19, and if they grow, they will grow slowly as they are not prepared to make sacrifices, in terms of current consumption and leisure, that are necessary for rapid growth. This also proves that this sector is dominated by income generating and is not growth motivated.

5.5 Financial performance of the microenterprise

This section tries to summarise the financial information of the two microenterprise groups, and highlight their overall performance ratios. Whilst it is possible to calculate large numbers of ratios, the approach adopted in this section is to select only those ratios which are likely to be essential to the understanding of a microenterprise's overall operating and financing indicators.

5.5.1 Operating ratios

5.5.1.1 Return on capital employed

The returns on capital in the microenterprise are very high by the standards of banks and other investors, as shown in table 5.21. The return on capital employed was calculated by dividing annual operating profit by the capital employed (year end). The reason, of course, is not that the owners of these microenterprises are rich, but that the investments are very small.

Table 5.21: Return on capital employed.

Activity	Formal borrowers			Informal Borrowers			Total		
	n	Mean	Std. Deviation	n	Mean	Std. Deviation	n	Mean	Std. Deviation
Manufacturing	11	201.7	336.6	9	226.9	338.9	20	213.0	328.9
Service	4	69.3	34.9	3	470.7	362.3	7	241.3	300.7
Trading	24	124.2	167.0	22	115.9	154.3	46	120.2	159.3
Trading & services	11	190.3	238.2	11	193.6	342.2	22	191.9	287.7
Total	**50**			**45**			**95**		

By comparing the means of the two groups, it was found that there are negligible differences between them, except for the service sector where there were a few extreme responses, but after adjusting those extreme values the mean was found comparable to the other group.

This finding lends relative support to the view that microenterprises are income generating rather than growth businesses. On the other hand, some researchers use this finding as a justification for supporting this sector. They found that this sector is likely to use less capital per unit of value-added created and a lot more labour per unit of value-added; hence, investment in these microenterprises in general will result in more growth in value-added and employment than in larger enterprises, and therefore is generally desirable (Elleithy 1996).

5.5.1.2 Net profit margin

Table 5.22 describes the net profit percentage for each group classified by type of activity. The ratio is calculated after dividing the net profit, after direct and indirect expenses have been deducted, by the annual turnover.

Table 5.22: Actual net profit percentage.

Activity	Formal borrowers			Informal Borrowers			Total		
	n	Mean	Std. Deviation	n	Mean	Std. Deviation	n	Mean	Std. Deviation
Manufacturing	11	63.7	60.2	9	80.4	74.5	20	71.2	65.7
Service	4	89.9	46.4	3	295.8	308.3	7	178.2	211.8
Trading	24	40.3	16.9	22	46.2	38.1	46	43.1	28.9
Trading & services	11	51.1	50.9	11	73.1	59.9	22	62.1	55.4
Total	**50**			**45**			**95**		

It was found that the overall net profit is higher than what a lot of people think of such a sector. Table 5.22 also shows that the net profit of the informal borrowers is relatively higher than that of the formal borrowers. This may be attributed to the high cost of borrowing paid by the formal borrowers group, in spite of the fact that the formal borrowers group have relatively higher turnover, as shown in figure 5.7.

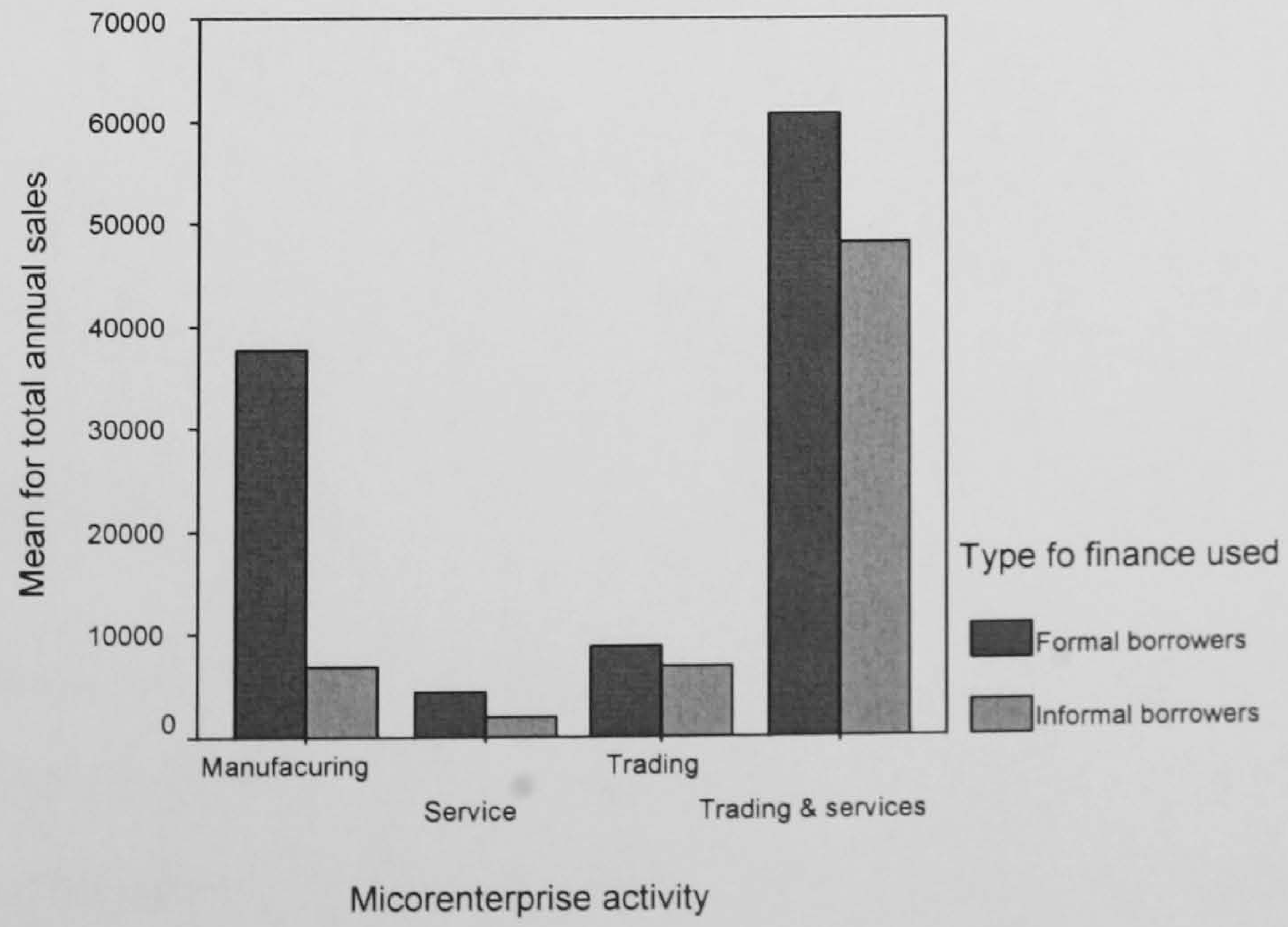

Figure 5.7: Means for total annual sales by microenterprise activity.

5.5.2 Financial ratios

The information on the financial structure is confined to the measure of the gearing ratio measured as the total external funds, including trade credit, divided by the current capital invested in the enterprise. The measure of the financial structure was confined to this ratio because it is among the easiest ratios to compute, and did not require the respondent to judge what is debt or how to distinguish among short, medium, and long-term debts. Gearing for both groups stood at an average value of 73 percent.

Table 5.23: Gearing ratio- debt to equity ratio- by respondents' group.

Type of finance used	Mean	N	Std. Deviation	Median
Formal borrowers	101.04	50	157.48	56.62
Informal borrowers	41.60	45	54.11	30.00
Total for both groups	**72.88**	**95**	**123.24**	**46.67**

It was noticed that the formal borrowers tend to have higher gearing ratios than the informal borrowers, as they borrow from any source, whether it is formal or informal, as shown in table 5.23. In table 5.23 the gearing ratio was calculated for every microenterprise and then the mean was calculated for the total sample. This is a reflection of their attitudes towards debts and borrowing in general. The formal borrowers group can be described as opportunistic. They borrow form all sources available as will be discussed in more detail in section 5.6.

Table 5.24: Gearing ratio- debt to equity ratio- by type of activity.

	Formal borrowers			Informal Borrowers			Total		
Activity	n	Mean	Std. Deviation	n	Mean	Std. Deviation	n	Mean	Std. Deviation
Manufacturing	11	58.8	345.8	9	33.0	42.5	20	102.2	260.4
Service	4	40.3	23.7	3	22.2	38.5	7	32.5	29.5
Trading	24	106.1	157.8	22	58.5	67.4	46	83.3	124.2
Trading & services	11	154.2	238.6	11	20.1	16.5	22	87.2	178.8
Total	**50**			**45**			**95**		

It was also noticed that the conventional features of the financial structure, e.g. gearing and the return on the capital employed, does not play a significant role in this sector's financial decisions. What is clear is that the optimal level of debt and equity in a microenterprise is usually a function of the characteristics of the microenterprise and its owner(s). As shown in table 5.24, the gearing ratios vary significantly according to the microenterprises' activities. These other non-financial explanations are in line with similar studies e.g. Islam et al. (1994), Baydas and Graham (1995) and Reid (1996). Non-financial explanations are further discussed in the next section.

5.6 The attitudes of the microenterprises' owners towards other financial matters

Understanding a microenterprise's finance behaviour is not simply about economics, it has as much to do with understanding people, their motivations, their perceptions, and their environment or culture in which they live, as discussed in the literature review chapter. Recent studies have questioned the attribution of the finance gap to merely supply side factors and argued that some micro and small enterprises deliberately constrain their debt options. In this section some of these other factors that play a role in this finance gap are discussed, starting, firstly with a discussion of how microenterprises owners perceive debt. Secondly, the perceived preference features of the different finance sources are discussed, formal and informal financing. Thirdly, the microenterprises constraints are discussed and this section concludes with two case studies of informal finance, which highlight the importance of this sector in the urban microenterprise finance.

5.6.1 Characteristics of debts

This section discuss the perception of debts by microenterprises owners as well as the main purpose of using debts, the extent of using banking services and the collateral given by microenterprises.

First with regard to the perception of debt, this study revealed several interesting findings regarding how a microenterprise perceives debt, which is in line with similar studies. For example, Reid and Jacobsen (1988) found that enterprises owners are reluctant to use debt finance, indeed there was uneasiness about the mere word debt; therefore, they used the word borrowing instead of debt in their study, which was found to be less sensitive. Also, as mentioned by Buckley (1997) the demand for credit means the same as the demand for debt, the difference is being whether one takes the creditor's or the debtor's viewpoint. Furthermore, it was noted that the microenterprises owners tend to limit their understanding of debt only to formal loans. Trade credit and customer advance are not perceived as debt but dealt with within the scope of the informal finance.

In this study the respondents' feelings towards debts were investigated as they were asked how they feel about being in debt. Table 5.25 summarises the answers to this question. The first group, the formal borrowers, has a completely different attitude towards debt, as they do not mind borrowing as long as they can repay back, 68 percent. On the other hand, the second group, 44 percent of the informal borrowers, does not like the notion of being in debt; never wanted to be in debt. As for their replies that they do not like, but they do not mind being in debt in case of necessity, 10 percent of the formal borrowers group and 15.6 percent of the informal borrowers group.

Table 5.25: How do you feel about being in debt?

Answers	Formal borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Do not mind as long as I can repay	34	68.0	16	35.6	50	52.6
Never want to be in debt	11	22.0	20	44.4	31	32.6
Do not like it but sometimes it is necessary	5	10.0	7	15.6	12	12.6
Do not know	0	0	2	4.4	2	2.1
Total respondents	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

By using a chi-square analysis to test for any statistically significant differences between the two groups (chi-square value = 11.194, degree of freedom = 3 and Sig. level = 0.011), the significant level is less than 0.05. Hence there are statistically significant differences between the formal and informal borrowers groups with regard to their personal attitude towards debts. This significant difference between the two groups may lend support to the assumption that some microenterprises owners often choose to select themselves out of the formal finance sector based on their interpretation of what debt means or represents.

To investigate this matter further, respondents to the previous question were reclassified according to their religion background, Muslims and Christians. The main reason for such an analysis is to know whether there is any difference in respondents with different religions backgrounds regarding perception of debts, table 5.26.

Table 5.26: How do you feel about being in debt- Muslim/Christian?

Answers	Muslims		Christians		Total	
	Frequency	%	Frequency	%	Frequency	%
Do not mind as long as I can repay	27	47.4	23	60.5	50	52.6
Never want to be in debt	21	36.8	10	26.3	31	32.6
Do not like it but sometimes it is necessary	8	14.0	4	10.5	12	12.6
Do not know	1	1.8	1	2.6	2	2.1
Total respondents	**57**	**100.0**	**38**	**100.0**	**95**	**100.0**

By using a chi-square analysis to test for any statistically significant differences between the two groups (chi-square value = 1.83, degree of freedom = 3 and Sig. level = 0.608), the significant level is found to be more than 0.05. Hence there are no statistically significant differences between the Muslims and Christians borrowers with regard to their personal attitude towards debts.

Second with regard to the actual usage of debt, the reasons for borrowing can be classified into two broad categories. The first category includes borrowing for business and investment purposes. The second category is borrowing for home consumption purposes, which is intended to meet the daily or seasonal needs of the home, or to finance contingencies. Due to the fungibility of credit, these discrete categories may not be easily distinguished, but this study tried to investigate this issue by asking both groups to indicate the sector they borrow from and the purpose of borrowing, whether it is for business or home consumption. Table 5.27 shows the results. The majority of the respondents mentioned that the formal loans are mainly used for business purposes, and only 3 percent mentioned that they use formal loans for home consumption as well. This observation is in line with similar studies in several African countries, which found that the formal sources of debt are primarily used for business purposes (Dunn 1996). As for the informal finance, the response was mixed as it is used for both business and home consumption. Also an important finding of this study is that the microenterprises rely on both formal and informal finances, which agrees with the findings reached by several studies e.g. McLeod (1992).

Table 5.27: Borrowing purposes / Usage.

Type of Finance	Purpose/Usage	Formal Borrowers		Informal Borrowers		Total	
		n	%	n	%	N	%
Formal Finance	For business	50	100.0	5	11.1	55	57.9
	For home consumption	3	6.0	1	2.2	4	4.2
Informal Finance	For business	41	82.0	28	62.2	69	72.6
	For home consumption	36	72.0	30	66.7	66	69.5

The observation that the formal sources of debt are being primarily used for business purposes reflects the fact that formal finance has high transaction costs (interest rate, collateral, etc.) than informal finance. Furthermore, it reflects the overall awareness and the high level of education among the microenterprises owners; unless there is a return for such loans they will not ask for them.

Third with regard to the extent of using banking services, this study revealed another interesting finding is that the majority of the microenterprises held at least one account with one of the commercial banks. 70 percent of the respondents from both groups were found to have bank accounts as shown in table 5.28; many respondents have loans and deposits at the same time. Both groups were asked about the main reason for opening a bank account; the different reasons given are summarised in table 5.28. The majority of the formal borrowers, 44 percent, mentioned that the main reason for opening a bank account is to have a formal loan.

Table 5.28: Reasons for opening a bank account.

Reasons	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
The bank/NGO would only lend if I opened a bank account	20	40.0	1	2.2	21	22.1
To facilitate my business transactions	11	22.0	12	26.7	23	24.2
My savings are safer in a bank	13	26.0	8	17.8	21	22.1
I get returns on my savings	0	0.0	1	2.2	1	1.1
Total respondents with bank accounts	**44**	**88.0**	**22**	**48.9**	**66**	**69.5**
Total respondents with no	6	12.0	23	51.1	29	30.5

bank accounts						
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

The most popular instruments used as security are post-dated checks; implied in the post-dated checks is the maturity period of the loan. Therefore, the microenterprises owners have to open bank accounts to receive a check book, and may close their bank accounts before the maturity of the check. 24 percent of the total respondents opened bank accounts to facilitate business transactions, and 22 percent of the total respondents use it as a saving channel. This high percentage of respondents dealing with banks indicates, as mentioned in a study by Baydas and Graham (1995), that microenterprises are not anti-banks, but may be anti-borrowing.

The culture does have an influence on people. Although the reasoning behind this cautious behaviour was not explored directly, attempts to capture some cultural aspects and attitude variables, which are not captured by the other questions, are made. Therefore, all respondents were asked if they had any strong reasons for not dealing with the formal financial sector, whether now for the informal borrowers group or in the past for the formal borrowers group. These subjective responses are presented in table 5.29.

Table 5.29: Reasons for not requesting a formal loan.

Reasons	**Formal Borrowers**		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
No need for loans at that time	27	54.0	14	31.1	41	43.2
Fear of inability of repayment	11	22.0	4	8.9	15	15.8
A religious objection to interest	1	2	14	31.1	15	15.7
Insufficient collateral	2	4.0	8	17.8	10	10.5
I do not want to be in debt	4	8.0	2	4.4	6	6.3
The loan amount is too small	4	8.0	0	0	4	4.2
Availability of other sources	1	2.0	2	4.4	3	3.2
No banking experience	0	0	1	2.2	1	1.1
High interest rate	0	0	0	0	0	0
High administration cost	0	0	0	0	0	0
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100**

The majority of the respondents replied that there was no need for capital at that time, 43 percent, and 16 percent mentioned that their primary reason was the fear of their inability to repay the loan. The religious reason, i.e. the objection to fixed interest, was mainly given by the informal group borrowers, where 31 percent mentioned it as a main reason; only 16 percent of the total respondents mentioned this as their main reason. 10 percent of the total respondents mentioned that they could not provide the necessary collateral, as will be discussed in the next paragraph. What could be noticed, also, from table 5.29, is that the borrowers' decisions may still be influenced by factors other than those usually typified as high interest cost or no banking experience, where in this study sample almost no one selected these reasons as the main reason for not having any loans. It was not possible to test the statistical significance of these differences, because in order to perform a chi-square analysis, the expected number for each cell must not be less than 5.

Fourth with regard to the collateral given, when enquiring from the respondents about whether they have given any form of collateral to obtain their informal finance, only 21 percent mentioned that they had to give collateral, which was mainly in the form of signing promissory notes or post-dated checks for the informal loans or goods they received on credit. Personal relations in informal finance allow lenders to make judgments about the creditworthiness of their borrowers and induce borrowers to fulfil the repayment promise without resorting to any forms of collateral. On the other hand, all respondents from the formal group of borrowers indicated that they had to present collateral for their loans. The formal loan collateral was in the form of post-dated checks or another government employee to guarantee the loan, or both in addition to supplying a valid business licence. Only 2 percent of the formal borrowers group mentioned they had to use land and building as a form of collateral. The rare use of collateral in the informal finance can be explained by the free flow of information between lenders and borrowers, and the fact that the informal financial market is dominated by personal relations that establish an effective enforcement mechanism in the case of default.

5.6.2 The microenterprises' preferences towards formal and informal finance

The terms of debt can also affect the borrowers' assessment of the desirability and feasibility of incurring debt from the different alternative sources. Hence microenterprises owners were asked to select three of what they prefer in both types of financing, the formal and the informal; such information on the terms of debt helped us to generalise about the differences between the formal and informal financing sectors.

First, the results for the formal financing perceived preferred features, or advantages, are ranked according to the mean of the respondents in table 5.30. The Mann-Whitney (M-W) U test was used to indicate the significant difference between the two groups, and an interesting finding was noted.

Table 5.30: Perceived advantages of the formal finance market.

	Mean Rank		
	Formal borrowers	**Informal borrowers**	**Significance level**
Offers other financial services e.g. saving	57.85	37.06	.000
Larger loans value	57.29	37.68	.000
Steady source of capital – availability	48.54	50.03	.179
Lower interest rate than informal sources	48.13	47.86	.950
Better collateral requirements	46.17	47.40	.821
Longer loan terms	33.50	62.70	.000
Total respondents	**50**	**45**	

Table 5.30 reveals that both groups' perception about the main features of the informal finance is completely different. The M-W U test indicated a statistically significant difference between the two groups, especially with regard to their views of the other financial services available, larger loan values, and longer repayment periods where the significance levels are less than 0.05. It was found that for the formal borrowers group the main preference for formal financing is that the formal financial markets offer more financial services in terms of savings and checking accounts, and larger loan values, while the informal borrowers group ranked these two features at the bottom. Regarding the loan payment period, the formal borrowers found it to be of least importance, where as the informal borrowers group, who mainly do not deal with the formal finance market, found it to be the most important feature of formal finance. This interesting finding could be useful in luring such sector into the formal finance market. However, as for the high interest rates and transaction costs, the respondents' perceptions were almost the same towards them, and there are no statistically significant differences among those two characteristics.

To investigate this matter further, the respondents were regrouped into Muslims and Christians, table 5.31. Overall, there was no significant difference between the two groups with regard to the perceived advantages of the formal finance market.

Table 5.31: Perceived advantages of the formal finance market grouped by religion.

	Mean Rank		**Significance level (p)**
	Muslims	**Christian**	
Offers other financial services e.g. saving	44.34	53.49	0.063
Larger loans value	45.22	52.17	0.194
Steady source of capital – availability	49.54	45.68	0.451
Lower interest rate than informal sources	46.94	49.59	0.365
Collateral requirements	49.18	46.22	0.511
Longer loan terms	51.95	39.83	0.008
Total Respondents	**57**	**38**	

Secondly, when asking both groups about their most preferred advantages or features in the informal finance market, and by using the M-W U test to indicate the significant differences between the two groups, this study found out that the only significant difference was with regard to interest, which is mainly due to religious reasons, as shown in table 5.32. With regard to the formal finance, both groups' perceptions about their preferences in the informal finance were almost identical, except for the religious reason.

Table 5.32: Perceived advantages of the informal finance market.

	Mean Rank		**Significance level**
	Formal borrowers	**Informal borrowers**	
Lower interest rate than formal sources	57.92	36.98	0.000
Social influence and trust	50.96	44.71	0.227
No forced saving or collateral	48.45	47.50	0.771
Payment flexibility	48.29	47.68	0.892
Freedom to use credit	47.73	48.30	0.880
Steady source of capital – availability	47.43	48.63	0.639
Efficiency compared to formal loans	47.36	48.71	0.799
Lower transaction costs	45.41	50.88	0.292
Agreeing to religious principles	40.22	56.64	0.000
Total respondents	**50**	**45**	

The M-W U test indicated a statistically significant difference between the two groups with regard to agreeing to religious principles, no fixed interest rate charged, and lower interest cost which is also related to religious principles. In both cases the significance level is less than 0.05. No interest, or lower interest, was one of the main features preferred by the formal borrowers group. As for the informal borrowers group, it was not of any importance as was shown in table 5.29; 31 percent of this group dealt with the informal finance market to avoid interest transactions. No significant relationship was found between the two groups with regard to all of the other factors asked to the respondents. The social reason, social influence, for joining was among the main features of the informal finance sector, but still the economic reasons dominated their preferences. Most of the informal loans were unsecured and provided free of interest charge except in a few cases. This is typical for informal loans, as it is socially and religiously unacceptable to charge interest or hold collateral.

To investigate this matter further the respondents were regrouped into Muslims and Christians, table 5.33. There was no significant difference between the two groups with regard to the perceived advantages of the informal finance market except for the compliance with religious principles.

Table 5.33: Perceived advantages of the informal finance market - by religion.

	Mean Rank		**Significance level**
	Muslims	**Christian**	
Lower interest rate than formal sources	44.95	52.58	0.125
Social influence and trust	47.71	48.43	0.891
No forced saving or collateral	47.00	49.50	0.453
Payment flexibility	49.48	45.78	0.538
Freedom to use credit	47.05	49.42	0.418
Steady source of capital – availability	47.82	48.26	0.867
Efficiency compared to formal loans	46.97	49.54	0.636
Lower transaction costs	49.75	45.38	0.410
Agreeing to religious principles	51.99	42.01	0.037
Total respondents	**57**	**38**	

Table 5.34 reveals that microenterprises borrow larger amounts from the formal financial markets, and at the same time borrow from informal sources, which is in line with what similar studies reported e.g. Dunn (1996).

Table 5.34: Value of loans in Egyptian pounds.

	Formal Borrowers		**Informal Borrowers**		**Total**	
Type of finance	**Value**	**%**	**Value**	**%**	**Value**	**%**
Formal finance	590,500	66	0	0	590,500	44
Informal finance	296,700	34	468,500	100	756,200	56
Total finance	**887,200**	**100**	**468,500**	**100**	**1,355,700**	**100**

5.6.3 The microenterprises' perceived constraints

The microenterprises owners are typically perceived to face problems and constraints limiting their growth and expansion. Most of these constraints are often attributed to the lack of finance. Problems outside the financial markets also constrain the microenterprises' abilities. To investigate this matter further from a microenterprise owner's perspective, the respondents were presented with seven items and were asked to evaluate their level of agreement to these items on a five-point Likert-type scale. The percentage, frequencies of responses in each category (none at all, to a limited extent, to an average extent, to some extent and to a great extent), table 5.35, and the overall rank for the two groups were compared for each item as given in table 5.36 and table 5.37 respectively. This scale was preferred to be used in the questionnaire and not to ask the respondents direct questions like in previous studies where the respondents simply answer yes or no. Also to avoid leading respondents to the issue of finance as the primary obstacle for developing MSEs, as in many other studies e.g. El-Mahdi and Osman (1999).

Table 5.35 revealed that the main constraint to the microenterprise sector is the market condition. As mentioned by one of the respondents, in the case of a weak market (low demand) what is he going to do with the extra money, if no one is buying like before? This reply shows that the macro economy, or the overall health of the economy, does have an effect on this sector.

Table 5.36 presents the data pertaining to the respondents of the two groups with regard to the most/least agreement with the constraints by the two groups. The overall mean ratings for these items ranged from the highest value of 4.6 (to a great extent), to the lowest value of 1.09 (none at all).

Table 5.35: The perceived constraints for the microenterprises' activities.

Variables	Groups	Frequency Percentage	Values					Raw Total
			None at all	To a limited extent	To an average extent	To some extent	To a great extent	
Problems related to markets	Formal Borrowers	n	0	1	4	9	36	50
		%	0	2.0	8.0	18.0	72.0	100.0
	Informal borrowers	n	0	2	2	10	31	45
		%	0	4.4	4.4	22.2	68.9	100.0
	Column Total	n	0	3	6	19	67	95
		%	0	3.2	6.3	20.0	70.5	100
Lack of basic public services	Formal Borrowers	n	12	8	13	14	3	50
		%	24.0	16.0	26.0	28.0	6.0	100.0
	Informal borrowers	n	13	12	5	8	7	45
		%	28.9	26.7	11.1	17.8	15.6	100.0
	Column Total	n	25	20	18	22	10	95
		%	26.3	21.1	18.9	23.2	10.5	100
Lack of access to finance	Formal Borrowers	n	18	14	7	3	8	50
		%	36.0	28.0	14.0	6.0	16.0	100.0
	Informal borrowers	n	8	20	10	4	3	45
		%	17.8	44.4	22.2	8.9	6.7	100.0
	Column Total	n	26	34	17	7	11	95
		%	27.4	35.8	17.9	7.4	11.6	100
Government regulations	Formal Borrowers	n	38	5	1	5	1	50
		%	76.0	10.0	2.0	10.0	2.0	100.0
	Informal borrowers	n	24	11	2	4	4	45
		%	53.3	24.4	4.4	8.9	8.9	100.0
	Column Total	n	62	16	3	9	5	95
		%	65.3	16.8	3.2	9.5	5.3	100
High cost of raw materials	Formal Borrowers	n	35	5	7		3	50
		%	70.0	10.0	14.0		6.0	100.0
	Informal borrowers	n	27	8	2	6	2	45
		%	60.0	17.8	4.4	13.3	4.4	100.0
	Column Total	n	62	13	2	13	5	95
		%	65.3	13.7	2.1	13.7	5.3	100
Lack of technology	Formal Borrowers	n	43	3	2		2	50
		%	86.0	6.0	4.0		4.0	100.0
	Informal borrowers	n	33	5	4	2	1	45
		%	73.3	11.1	8.9	4.4	2.2	100.0
	Column Total	n	76	8	6	2	3	95
		%	80.0	8.4	6.3	2.1	3.2	100
Lack of saving facilities	Formal Borrowers	n	47	1	1	1	0	50
		%	94.0	2.0	2.0	2.0	0	100.0
	Informal borrowers	n	42	2	1	0	0	45
		%	93.3	4.4	2.2	0	0	100.0
	Column Total	n	89	3	2	1	0	95
		%	93.7	3.2	2.1	1.1	0	100

Table 5.36 shows that the most significant constraints reported by the microenterprises owners were weak demand, lack of public services and lack of access to finance. The lack or the inadequacy of credit for working capital was ranked as the third constraint, and not as the major perceived constraint. By applying

the M-W U test to test for any statistical differences between the two groups, with regard to their perceived constraints, the M-W U test did not indicate any statistically significant difference between the two groups, except for one characteristic which is related to the government regulations where the significance level is less than 0.05, as shown in table 5.36.

Table 5.36: Constraints and problems facing microenterprise owners classified according to formal and informal borrowers.

Variable	**Mean**			**Significance level (P)**
	Formal borrowers	**Informal borrowers**	**Overall Mean**	
Problems related to markets: weak demand, more competition	4.60	4.56	4.58	0.773
Lack of basic public services	2.76	2.64	2.71	0.630
Lack of access to finance	2.38	2.42	2.40	0.430
Government regulations	1.52	1.96	1.73	0.029
High cost of raw materials	1.76	1.84	1.80	0.452
Lack of technology	1.30	1.51	1.40	0.135
Lack of saving facilities	1.12	1.09	1.11	0.923
Number of Respondents	**50**	**45**	**95**	

To enrich the analysis further, the perceived constraints according to the microenterprises' growth were compared. The comparison was based on the enterprises' negative or positive growth as shown in table 5.7. The overall mean for the two groups were computed for each item as shown in table 5.37.

Table 5.37: Constraints and problems facing the microenterprises owners classified according to growth potentials.

	Mean			**Significance level (P)**
	Microenterprise that have not grown	**Microenterprise that have grown**	**Overall Mean**	
Problems related to markets: weak demand, more competition	4.74	4.53	4.58	0.305
Lack of basic public services	2.43	2.79	2.71	0.304
Lack of access to finance	2.43	2.39	2.40	0.268
High cost of raw materials	1.52	1.89	1.80	0.112
Government regulations	1.57	1.78	1.73	0.345
Lack of technology	1.13	1.49	1.40	0.818
Lack of saving facilities	1.04	1.13	1.11	0.636
Number of Respondents	**23**	**72**	**95**	

Table 5.37 shows that there is also no statistical difference between both groups with regard to their perception about business constraints. The M-W U test did not indicate any statistically significant difference between the two groups, where the significance level is more than 0.05 (see table 5.35).

Tables 5.35, 5.36 and 5.37 reveal that the principal constraint faced by a microenterprise is the market condition. These results are similar to a study by Baydas and Graham (1995) focusing on financial reforms for small business development in Egypt. Despite the focus of their study being on small and medium enterprises, they also managed to collect data on the microenterprise sector. In their study many microenterprises owners indicated that their financial problems would not be solved by borrowings and that the weak demand and strong competition may be the main causes of financing problems. Also, similar to studies by Aryeetey et al. (1994), Daniels et al. (1995), Sisken (1996), Elleithy (1996), and Baydas et al. (1997b), where it was found that the broad economic trends have a direct effect on the micro and small firm sector, and that the macro-environment factors of economic expansion and contracting affect the microenterprise more directly.

From this preliminary descriptive analysis the lack of microenterprise financing was not found to be a major constraint or problem, contrary to the popular belief, as will be discussed in further detail in the next chapter. The point is that many other types of problems are mistakenly identified as issues of capital; weak markets, or lack of proper infrastructure can all appear to be finance problems. Therefore, the lack of loans is not the binding constraint that limits expansion, from the microenterprises owners perceptive. Schools, clinics, roads or better market conditions would typically be more important than loans in contributing to the microenterprises' growth (see table 5.35).

5.6.4 Informal finance (RoSCAs – two case studies)

During the field study, the researcher heard about some interesting informal financial activities that were taking place. Although they were not within the study sample, they were very interesting and significant in scale to this study that the researcher found that there is a need to document those two cases in this study.

The first case is a *Gam'iya* or RoSCA for 30,000 Egyptian pounds a day with around 75 participants. The organiser of this RoSCA was met, which is mainly between traders in a highly dense market area of Cairo in a district called Al-Moskey. This district is one of the oldest shopping areas in Egypt, in old Cairo, a high density populated area. The organiser of this Gam'iya has owned a wholesale cloths shop for 35 years. He started this business with his father and only two employees, now he has 4 employees in this shop. The organiser's age is 62, and as for his education, he finished high school. The total value of the saving pool was 30,000 Egyptian pounds, and divided into 60 shares, each for 500 Egyptian pounds. Some participants have more than one share, while others participate in one share. Every RoSCA member, i.e. trader, receives this pot every 60 days. The organiser, the RoSCA leader, of this *Gam'iya* indicated that during the good market conditions in the previous years, this *Gam'iya* exceeded 100,000 Egyptian pounds daily, which with the Egyptian standard is a very large amount. The traders or participants receive this pot every 60 days, mainly to finance their working capital by buying new goods on a cash basis, where they can save between 15-35 percent on buying goods on a cash basis, and have more preference in selecting their types of goods, than if buying on credit. The RoSCA leader indicated that the prices they were charged for the goods bought on credit were higher than the prices charged for the same goods bought on a cash basis; hence this was among the main motives for participating in such a scheme.

The second case is also related to a *Gam'iya* formed instantly by traders to face an emergency situation. It was formed when a food retailer shop has been burnt. His colleagues in the same area raised around 50,000 Egyptian pounds for him to restart his business. This food retailer started his business 18 years ago with one employee. He has not completed his school education but he can read and write. Currently he runs his business with two of his sons, who completed their university studies, and 2 employees. The *Gam'iya* was formed within a few days of the tragic accident and he received the first pot. This amount was to be repaid over a one year period. The researcher managed to meet the person who benefited from this pot and asked him if he has tried to apply for a bank loan. He answered that no bank would lend him in his case, as he was not insured against fire or theft and the bank demands a lot of guarantees and paper work and may not give the same amount that was raised through the RoSCA within the same time period.

The above two cases refute a lot of arguments that the amount of loans raised in the informal sector is lesser or insufficient compared to the formal sector. e.g. Mohieldin and Wright (2000) who conclude in their study about the informal finance in Egypt that borrowing from the formal sector often involves larger loan sizes and longer repayment periods compared to the informal finance. Furthermore, these two cases not only reflect the size of the informal sector, but the speed with which such a service is offered in the face of an emergency. The next chapter will discuss in detail how the above two cases contradict what other researchers assume about the informal finance sector as being usually small and inefficient.

5.7 Summary and conclusions

The aim of this chapter was to give an in-depth insight into the study sample, the urban microenterprise. The personal characteristics of the microenterprise owners, the respondents, although not representative of the microenterprise population as whole as identified in chapter 4, do tend to reflect the findings of similar microenterprise studies, as mentioned above. On the whole, the results presented in this chapter suggest that there are considerably more similarities than differences between the two groups, than would have been expected given the findings of other researchers.

Also, the microenterprise characteristics on which the two groups were compared are similar, and the overall systematic differences between the two groups that might influence their financing decision are negligible. Those few statistically significant differences between the two groups of respondents, in terms of their enterprises and personal characteristics, have no strong impact on verifying the study research hypotheses as will be discussed in detail in the next chapter. It should also be noted that this chapter revealed that there were no significant differences between Christians and the Muslims with regard to their perception about debt and the perceived advantages of the formal and informal finance. Therefore, it can be concluded that selecting the sample form an area with a high population of Christians does not have a significant bias affect on the study results.

Furthermore, this descriptive chapter, revealed the important role of the behavioural element in the financing decision of the microenterprise as mentioned by Sargent and Young (1991) and Read (1998). The fact that the financing of microenterprise is closely entwined with the microenterprise owner's life situation, is in line with North's (1995) arguments that the individuals may choose more costly transactions, if they possess different mental models to interpret the world around them. North (1995) mentions that not only the rationality postulate prevents the actors from achieving the joint maximisation result, but also the specific characteristics of transacting.

It should be concluded, as mentioned by several researchers e.g. Read (1998), that the microenterprises owners who borrow from formal sources may have unobservable traits, such as more entrepreneurial ability, that would make them more likely to have higher levels of impact on their enterprises, even without access to more finance sources.

Chapter Six: Microenterprise Survey Findings

6.1 Introduction

The role of finance has been viewed as a critical element for the development of MSEs. Previous studies have highlighted the negative effects of the limited access to financial resources available to smaller enterprises compared to larger enterprises at the start up phase and during their growth and development (Levy 1993). In recent years, both policy makers and researchers have become interested in the importance of microenterprise, as discussed in chapter one. Recognising that microenterprises play an important role for economic growth and job creation in the society, policy makers tried to shape the demand of finance by adopting the supply leading strategy, which was promoted by several researchers e.g. Patrick (1983), as discussed in chapter two. Direct credit programs for MSEs that assume that the demand for credit far exceeds supply started to spread in the developing countries, including Egypt, as discussed in chapter three. Nevertheless, this supply-leading finance approach has been criticised extensively by Adams and Graham (1981) and Adams (1984) on the basis that demand for the output of the microenterprises being financed would not necessarily emerge to follow the supply of finance and therefore leads to a misallocation of the scarce resources. The underlying assumption that the financial problems restrain MSEs' development and growth has been questioned by several researchers as well as in public debates (Lapar 1991; Baydas et al. 1997b; Buckley 1997; Read 1998; Howorth 1999; Cook and Nixson 2000; Ozer and Yamak 2000). Furthermore, several studies show that a large number of MSEs fail because of non-financial reasons (Liedholm and Mead 1999).

Within the above context the lack of finance facing microenterprises seems to be a recurring theme. Several studies have referred to the financial gap facing MSEs, assuming that this gap is mainly due to a limited supply of capital, and that by making capital available this will enhance the development of microenterprises; hence, achieving the governments' twin goals of reducing poverty and increasing employment. Therefore, much of the research on MSE finance has focused on constraints in the supply of institutional finance, whereas the handling of financial needs at the demand side; i.e. the MSEs owners' perspective, has been given much less attention. Furthermore, financial problems in MSEs have been explained by reasons such as the information asymmetry experienced by the financiers, the high risk involved in financing MSEs, and the relatively high transaction and monitoring costs involved. Therefore, a large number of questions remain unanswered in relation to finance and microenterprise development. These include those directly related to the urban microenterprises category, as noted earlier, especially with regard to what goes on inside the microenterprises and the role of alternative finance sources including informal finance. In order to answer these questions this study used a quasi experimental design, as discussed in chapter four.

Hence this chapter, in light of the previous descriptive chapter, chapter five, attempts to test the research hypotheses, and answer the two main research questions raised from the literature review. The first research question was: is there a relationship between the growth of microenterprises in urban Egypt and the different forms of finance, formal and informal, where the existing research on MSEs has not isolated the importance of the different forms of finance? The second research question was: is the primary explanation for urban microenterprises' lack of use of formal finance due to the personal characteristics specific to the microenterprises owners, or is the explanation more general in nature? Therefore, this chapter will deal with the seven research hypotheses derived from the above two research questions and the literature review. Each one of the research hypotheses is restated and then the findings related to the hypothesis are presented. It should be noted that when interpreting the findings of this study, consideration is given to patterns of similarities or differences between the two groups, formal and informal borrowers. Also caution needs to be taken with certain words used, e.g. "difference" doesn't imply absolute difference, but it may be said that there is a significant tendency of difference.

6.2 Finance as a major constraint for microenterprise

The first hypothesis: The limited access to formal finance services to meet the working and fixed capital needs on a sustainable basis is the major constraint for microenterprise development.

The first hypothesis is based on the reported responses of most of the surveys that finance is the main constraint microenterprises owners face, and that they often fail to secure the capital they need and miss opportunities for business growth e.g. El-Mahdi and Osman (1999) and Heino and Pagán (2001). Some researchers view the less developed countries as identical to the more-developed countries, except for this lack of capital and possibly certain inefficiencies in resource allocation (Stiglitz 1999). The issue of whether finance is the major constraint to the creation and expansion of small firms, or if other constraints are more important, such as weak market demand, lack of managerial and technical know-how, or poor marketing channels is not very clear (Assaad and Rouchdy 1999). Despite the presence of multiple, and often interrelated, constraints, as shown in table 5.35, the widespread belief on which policies to support MSEs are based is that the lack of finance, equity or debt, constitutes the main constraint to the growth of MSEs. This often reported constraint is based on results from surveys in which microenterprise owners are asked to indicate whether the lack of credit is a problem for a microenterprise or not; results from these surveys are not very useful for formulating policy because they do not separate people who are credit constrained from those who are not credit constrained. As mentioned by Dichter (1999), many researchers tend to emphasise the importance of credit to the extent that they forget that credit is also debt; hence, they miss an important part of the demand picture. To determine whether there is an effective demand for credit or not requires assessing the ability of potential borrowers to repay loans, which is difficult because it requires judgments about the future behaviour of borrowers, and the future profitability of the microenterprise. The fact that respondents say they need credit does not equate what the economists call effective demand. One has to look at their capacity to repay debt and their capacity to service it. Therefore, to get over these obstacles this hypothesis was tested through an indirect approach.

Two questions were asked for both groups to test the first hypothesis. For the first question, the respondents were presented with seven items and were asked to evaluate their level of agreement to these items on a five-point Likert-type scale. It was preferred to use this scale in the questionnaire, and not to ask the respondents a direct question like other studies, e.g. Daniels et al. (1995) and El-Mahdi et al. (1999), where the respondent could simply answer a question with "yes" or "no". This chosen format reflects the real extent of significance of each constraint perceived by the respondents. The percentages and frequencies of the responses in each category (none at all, to a limited extent, to an average extent, to some extent, and to a great extent) are shown in table 5.35. The overall ranks for the two groups were compared for each item (table 5.36), where the respondents were classified according to formal and informal groups, and table 5.37, where the respondents were classified according to their growth potential. In both classifications, the lack of access to finance was ranked to be the third important constraint by both groups after the weak market demand and the lack of proper infrastructures and utilities. The Mann-Whitney test was used to test for any significant difference between the formal and informal borrowers groups, table 5.36, and the growth oriented and non-growth oriented groups, table 5.37. The results, according to Mann-Whitney U test, show that there is no significant difference in the mean scores of responses between the two samples, informal and formal borrowers ($P = 0.430$), or growth and non-growth enterprises ($P = 0.268$) with regard to perceiving the lack of credit as a major constraint. Thus, it can be said that in both samples, the formal and informal borrowers groups perceive the lack of finance not to be the major constraint.

Secondly, both groups were asked if they believed that without formal borrowing they would have been able to operate their businesses. Surprisingly, as table 6.1 shows, the majority replied "yes" to this question. The reported responses were almost similar for both groups, those who have and those who do not have formal loans.

Table 6.1: Without formal borrowing, would you have been able to run your business?

Answer	Formal Borrowers		Informal Borrowers		Total	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Yes	44	88.0	42	93.3	86	90.5
No	6	12.0	3	6.7	9	9.5
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

This interesting finding was further tested by using a chi-square analysis to test for any statistically significant differences between the two groups (chi-square value = 0.786, degree of freedom = 1, and Sig. level = 0.375), and the significant level was found to be more than 0.05. Hence there are no statistically significant differences between the formal and informal borrowers groups. This finding could be interpreted as either that the lack of formal finance does not represent a real constraint to the microenterprise sector, or that the amount of loan offered to this sector is insignificant, or too small, compared to its volume of activities. The current maximum value of loans offered to formal borrowers in this study is 15,000 Egyptian pounds. The first interpretation would lend strong support to the rejection of the research hypothesis.

It is worth mentioning that the need for start-up capital was disregarded in testing this hypothesis, as shown in the previous chapter, table 5.11; the majority of the microenterprise sector required a very small amount of start-up capital. This is also mentioned by Liedhom and Mead's in Rhyne and Otero (1994), as in several other countries they found the initial capital requirements ranging from 250 Egyptian pounds, in Sierra Leone, to 5,000 Egyptian pounds, in Jamaica, and that the requirements for working capital are likely to be relatively large, which is inline with this study sample. Furthermore, to test the starting capital constraints accurately, one need to have historical information over a period of time as in the study by Evans and Jovanovic (1989) of small businesses, such information was not available for this study. Evans and Jovanovic's study pointed out that there might be an impediment for starting up an enterprise and for sustained growth due to lack of finance. They argue that capital is essential for starting a business and liquidity constraints tend to exclude those with insufficient funds at their disposal. Their conclusion was based on panel data, gathered over different periods, of ordinary workers, and after a certain period they investigated why those workers have not transferred to self-employment activities. On the other hand, several researchers found that the inability to raise the required capital is in itself an indication of the weak entrepreneurial traits, and that those people can not be successful in their businesses, even if they were provided with the required capital (Buckley 1997).

As for the lack of the finance's effect on the future of microenterprises, contrary to some expectations, the lack of finance is not the binding constraint that limits the expansion of microenterprises as was shown in table 5.20. Many microenterprise owners, 37 percent, do not have clear plans for the future, and less than 25 percent are willing to borrow to finance any future expansion.

Therefore, the notion that the lack of finance is the major constraint for microenterprises is not supported by this study. Although the analysis revealed that there is a certain constraint on the supply of finance in terms of working and fixed capital, but it is not the major constraint for microenterprises operating in this sector. Hence, the lack of finance is not the most important problem faced by most microenterprises, but the poor market conditions and the lack of proper public services, utilities and health care, turned to be more important factors in limiting microenterprise development, table 5.35.

This result contradicts several research work in different countries, e.g. the work by Heino and Pagán (2001) in Mexico, where they found evidence that liquidity constraints in the credit market hinder the creation and growth of MSEs. Also, in the study by Daniels et al. (1995) in Kenya, the lack of finance was the major constraint, and a weak market was the second major constraint. On the other hand, the findings is in line with other research work carried out, such as that in a study by Baydas and Graham (1995); the most significant problems reported by microenterprises were weak demand, and finance was reported as the second most serious problem. Also a detailed analysis of microenterprises in Bangladesh by Islam et al. (1994) mentioned that few entrepreneurs need credit from an external credit source; many of them seem to prefer trade credit, or credit provided by the family. Islam et al. found that many MSEs do not need formal credit to survive or to grow to a viable size. A similar study in South Africa found that many, but not most, microenterprises included in the analysis are credit constrained, where 48 percent of all of the MSEs in the sample are credit constrained (Machethe 1997). Furthermore, as argued by Liedholm and Mead (1999), the true need for finance, particularly for working capital, is lower than the respondents' perceived demand for it, as the working capital shortages are often the symptom of some other problems like raw-material or managerial inefficiencies.

McLeod (1992) mentioned that those who favour the finance constraint explanation however must explain why many new entrepreneurs are able to overcome financing obstacles to their progress while others cannot. It seems much more plausible to argue that the lack of entrepreneurial ability makes access to finance difficult, rather than that the lack of access to finance holds back entrepreneurship. Whether finance or entrepreneurship is lacking is still a debatable issue which needs further research within the Egyptian context.

6.3 Growth implications

Microenterprise finance is generally believed to contribute directly to the growth or the stability of the enterprises' income and the enterprises' net worth, especially in the developed countries, where the weight of the liquidity constraint is so great that the financial system can be blamed for the disappointing growth of the MSEs sector. However, does finance matter in the growth and survival of microenterprises in developing countries? Several studies have been under taken on the small scale enterprise as discussed in chapter two, and several empirical studies have assessed the impact of access to finance on the performance of MSEs, especially microfinance impact studies e.g. Dunn (1996), Hulme and Mosley (1996b) and Cohen (2001). Microenterprises' growth can be measured in different ways; the traditional measures of growth, as mentioned by Sebstad et al. (1995), are in terms of income, fixed assets accumulation, or employment. Furthermore, there is another type or form of growth which is in the form of opening new firms or diversification into new businesses, which is common among this sector. Microenterprises replicate themselves in an amoeba like fashion, as mentioned by Tinker (1995); this sector grows by opening new shops and not in a hierarchical employer employee pattern. It is difficult to measure the direct effect of finance on this type of growth; therefore, it is disregarded in this study. The study is limited to measuring the effect of finance on growth in terms of an increase in net income, employment, and fixed assets accumulation.

6.3.1 Finance and net income

The second hypothesis: Microenterprises which use formal finance have their net income increase significantly compared to microenterprises which do not use formal finance.

The second hypothesis, in alternative format, that microenterprise access to formal finance increases enterprise net income is based on the common assumption adopted by many microenterprise support programs. All microenterprise support programs, and indeed virtually all aid financed initiatives, adopt the assumption that intervention will lead to an increase in the enterprise income and this income will be reinvested in the business, leading to growth of the enterprise and an increase in enterprise net worth. The issue that this sector would reinvest the excess income in the business could not be substantiated as discussed in chapter five. As shown in figure 6.1 there is almost no or a weak relation between the microenterprise growth and the annual net income.

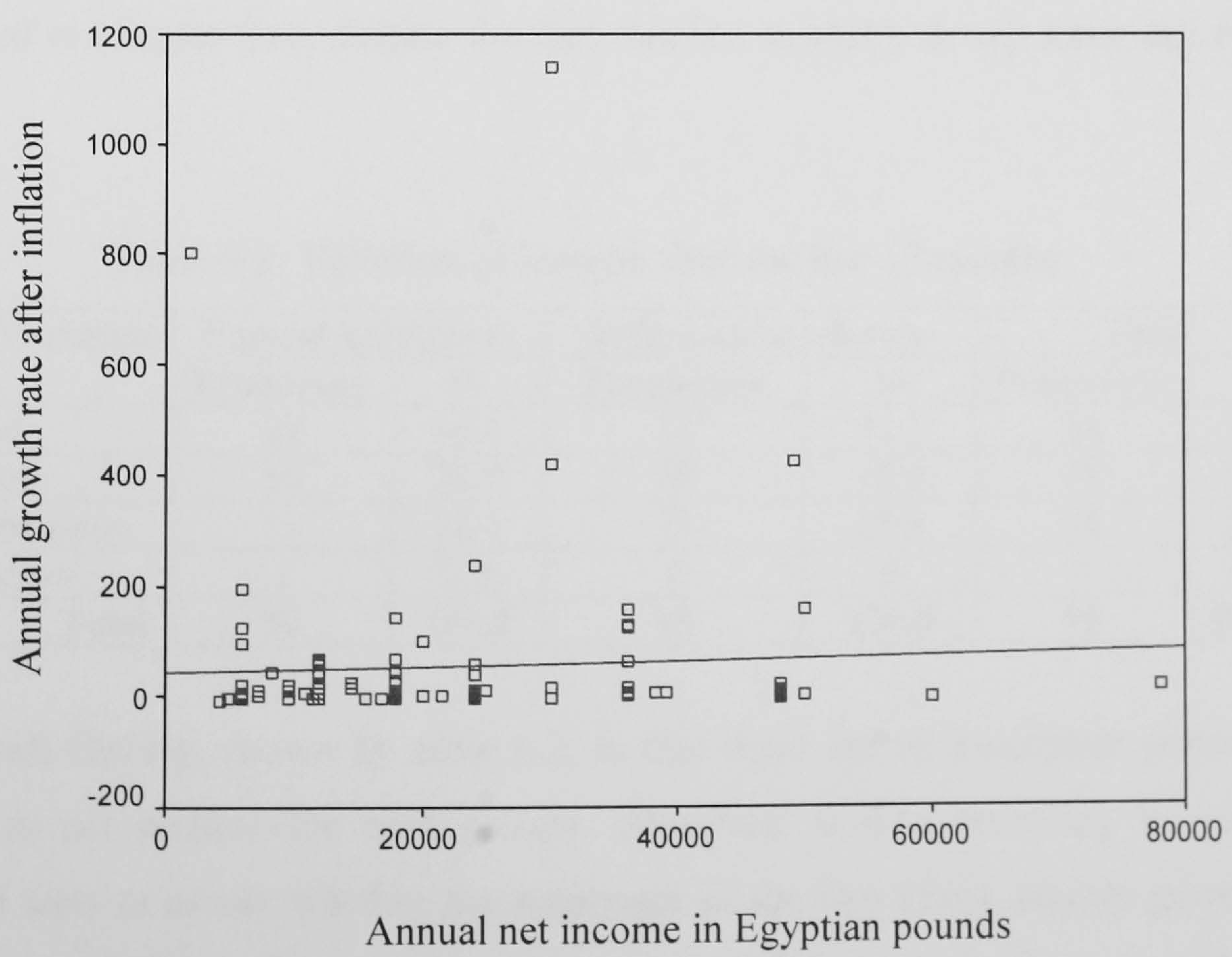

Figure 6.1: Relation between microenterprises growth and annual net income

Most microfinance impact studies regard income as a critical variable for measuring the impact of microenterprise credit services, and a general indicator of enterprise growth. Income flows tend to vary greatly within or between time periods due to regular factors such as seasonal changes. Because of these fluctuations, many researchers recommend collecting income data through a frequent, multiple visit, approach which can be very costly to implement. Alternatively, this study relies on the respondents' recall of data over a one year period. The method of respondents recall of data was criticised by several researchers e.g. Inserra (1996), but the alleged inaccuracy and distortion of the data due to recall errors was as much as possible avoided with extra due care exercised during the data collection as discussed in chapter four. Income for productive activities is often measured as net income; therefore, the term used in this study will be net income.

This second hypothesis is tested by asking the respondents to identify changes in their net income over the last 12 months compared to the previous period. Table 6.2 shows that income has increased for at least 38 percent of the enterprises, while it remained the same for 25 percent and declined for 36 percent. Only 1 percent of the respondents could not identify the changes over the last period in their net income. This high percentage of the respondents' ability to identify the changes in their net income demonstrates the overall awareness of this sector of their financial income, as mentioned in chapter five, despite the fact that the majority do not have any formal records.

Table 6.2: Variation of income over the last 12 months.

Income Variation	**Formal borrowers**		**Informal borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Increased	22	44.0	14	31.1	36	37.9
Decreased	16	32.0	18	40.0	34	35.8
Stayed the same	11	22.0	13	28.9	24	25.3
Do not know	1	2.0	0	0	1	1.1
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

The overall finding, shown by table 6.2, is that there are no consistent patterns of changes in net income for both groups. Therefore, it was necessary to perform statistical tests to assess whether the responses of the two client sample groups are significantly different. By using a chi-square analysis to test for any statistical significant differences (Pearson chi square 2.807, df 3, and sig. 0.211) between the two groups, it was found that there are no statistically significant differences between the formal and informal borrowers groups with regard to the variation of net income over the last year. In order to investigate this matter further, the groups were classified according to their negative and positive growth (table 5.7), as shown in table 6.3. It is clear form this table that the microenterprises with positive growth reported a great increase in their net income compared to the enterprises with negative growth. The majority of negative growth enterprises reported a decrease in their income over the last year.

Table 6.3: Variation of income over the last 12 months classified by microenterprises' growth.

Income Variation	Formal Borrowers		Informal Borrowers		Total	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Microenterprise with negative growth						
Decreased	6	60.0	8	61.5	14	60.9
Increased	0	0	1	7.7	1	4.4
Stayed the same	3	30.0	4	30.8	7	30.3
Do not know	1	10.0	0	0	1	4.4
Sub-total	**10**	**100.0**	**13**	**100.0**	**23**	**100.0**
Microenterprise with positive growth						
Decreased	10	25.0	10	31.3	20	27.8
Increased	22	55.0	13	40.6	35	48.6
Stayed the same	8	20.0	9	28.1	17	23.6
Sub-total	**40**	**100.0**	**32**	**100.0**	**72**	**100.0**
Total	**50**		**45**		**95**	

However, while there is no statistical difference between the two groups, more formal borrowers, 44 percent, reported an increase in net income compared to the informal borrowers group, 31 percent, as shown in figure 6.2. This trend towards the increase of net income of the formal borrowers group can be interpreted, as pointed out by several studies e.g. McLeod (1992) and Dichter (1997), that formal credit may help in lowering costs resulting from reducing reliance on supplier credit, resulting in lower cost inputs, more choice and quality of inputs.

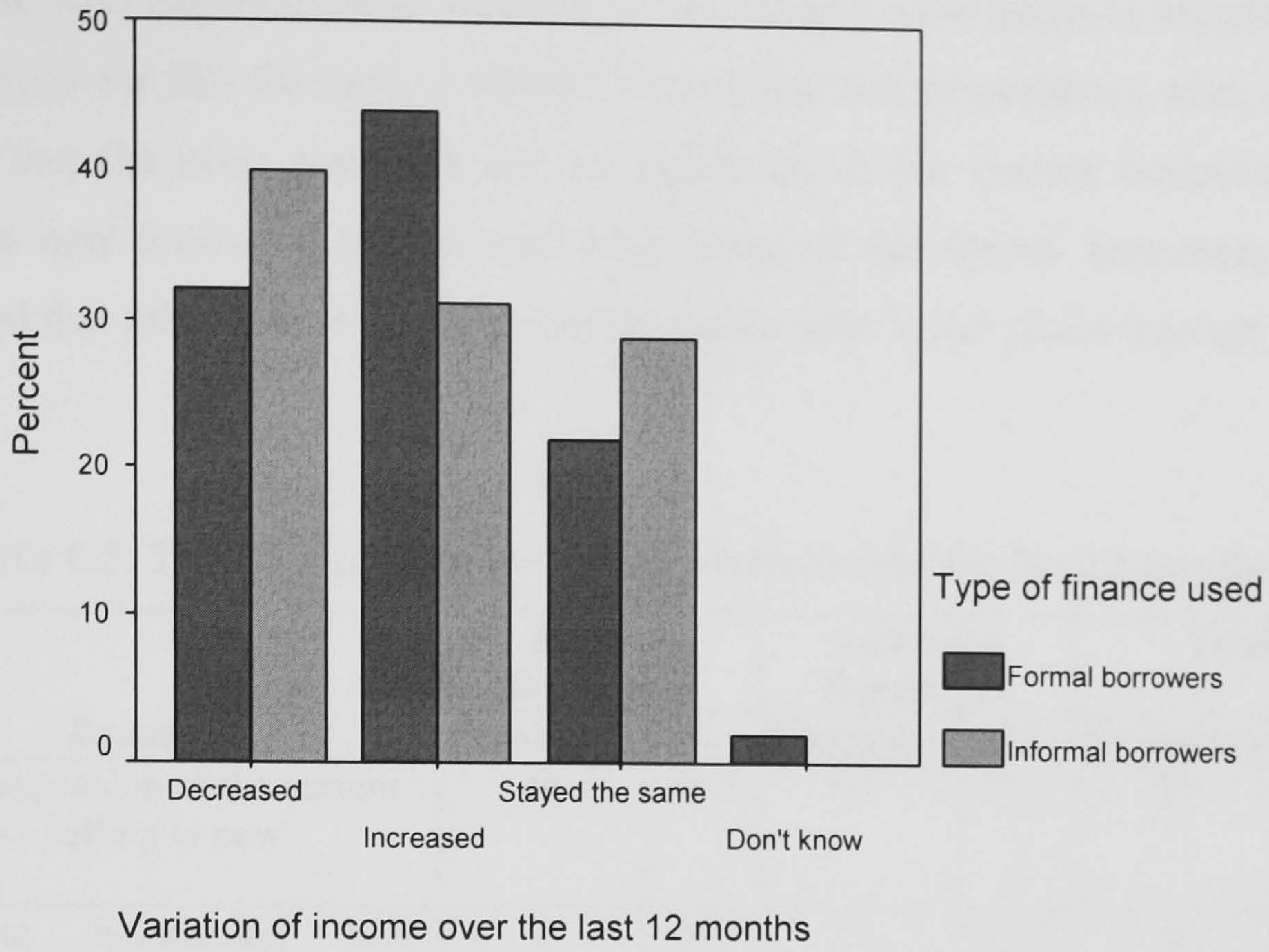

Figure 6.2: Change in microenterprises' net income over the last 12 months.

To further investigate the main reason for these changes in net income over the last year, both groups were asked to identify the factors behind this change. Table 6.4 revealed an interesting finding, when both groups were asked to identify the main reason for the decrease in net income over the last year, major financial constraints or reasons were never mentioned among the major problems. This finding is in line with a similar study by Baydas et al. (1997b). The microenterprises largely reported weak demand and domestic competition as their primary reasons. Also table 6.4 shows consistency with the respondents' perception that the market conditions is the major constraint on their activities as concluded in the previous section and in chapter five.

Table 6.4: The main reasons for income decrease over the last 12 months.

Reasons	Formal Borrowers		Informal Borrowers		Total	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Due to bad market conditions	7	43.7	9	50.0	16	47.1
Due to strong competition	4	25	7	38.9	11	32.3
Due to illness	5	31.3	2	11.1	7	20.6
Unable to get input at lower prices	0	0	0	0	0	0
Due to higher cost of finance	0	0	0	0	0	0
Due to inability to find finance	0	0	0	0	0	0
Due to liquidity and cash shortage	0	0	0	0	0	0
Total	**16**	**100.0**	**18**	**100.0**	**34**	**100.0**

Also those who experienced an increase in net income were asked to identify their main reasons for this increase. Table 6.5 shows that microenterprises, also, largely reported that the main reason is due to expansion of the current businesses and selling in new markets. Only around 14 percent of the formal borrowers group mentioned that this increase is due to buying goods with lower prices through formal loans.

Table 6.5: The main reasons for income increase over the last 12 months.

Reasons	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Due to expansion of the current business - selling in new markets	16	72.7	10	71.5	26	72.2
Due to introducing new products	2	9.1	3	21.4	3	13.9
Due to lower input prices - reduce cost with cheaper finance	3	13.6	1	7.1	5	11.1
Due to good market conditions	1	4.6	0	0	1	2.8
Due to hiring new workers	0	0	0	0	0	0
Total	**22**	**100.0**	**14**	**100.0**	**36**	**100.0**

Hence the hypothesis is rejected as the statistical analysis could not show any statistical significant difference between the two groups. Furthermore, contrary to the popular belief, finance was not reported to be the major reason for net income decrease. These findings further suggest that the formal finance contributes to sustained growth among only a small proportion of microenterprises, while the large majority grow only up to a point, then level out regardless of accessibility to finance, as discussed in chapter five and shown in figure 5.5 and figure 6.1. Nevertheless, the lack of access to credit does curtail the exploitation of highly profitable opportunities, as shown in table 6.5 and seen from figure 6.2, where the increase in net income of the formal borrowers group compared to the income of the informal borrows group who restrict, or often select, themselves out of the formal sector is relatively more. As mentioned by Aryeetey et al. (1994) in a similar study, the evidence suggests that exploitation of highly profitable opportunities by MSEs could be accelerated if they had greater access to external financing.

In support of these findings, Buckley (1997) mentioned that microenterprise finance cannot be just assumed to improve enterprise performance. the case must be proven. He found little evidence in his research in several African countries to suggest significant and sustained positive impacts for finance. Even evidence from Kenya shows a downward trend in profit margins for borrowers (Buckley 1996). Also a study by Lapar (1991) and Montgomery et al. (1996) found the impact of formal finance to be limited on income increase and to a larger extent depends on market conditions which is also supported by this study, as was argued in detail in chapter five.

On the other hand, the findings contradict findings by several studies that alleged the significant role finance plays in the growth of this sector. Most of these studies were sponsored by donor and aid organisations. For example, in an overview of twenty six studies on the impact of microenterprise credit by Sebstad and Chen (1996), it was found that most of these studies reported an increase in income for at least half of the enterprises, while it remained the same or even declined for the others. Also in studies by Mosley (1996) in Indonesia, Hulme et al. (1996) in Sri Lanka, and Mosley (1996) in India; they found a stronger tendency of increase in income in the period following the loan than with the non borrowers, control group. These contradictory findings may be due to the pre-existing differences between microenterprise owners who chose to access formal finance and those who did not.

6.3.2 Finance and employment creation

The third hypothesis: Microenterprises which use the formal finance have their employee number increase significantly compared to microenterprises which do not use the formal finance.

The hypothesis that microenterprises' access to formal finance increase growth potential through the increase in microenterprises' employees is derived from the assumption that microenterprise finance allows the enterprise to absorb more of the unemployed labour. It is often argued that MSE promotion is justified on grounds of the job-creating ability of MSEs (Abd El-Mageed 1998; El-Mahdi and Osman 1999). The contribution of microenterprises to the creation of new jobs has been a controversial issue around the world. The generation of employment has been widely cited as a direct effect of microenterprise finance programmes that helps with microenterprise growth e.g. Sethuraman (1981). This belief is strongly contested by the doubtful effectiveness of most programs that attempted to address employment directly by targeting financing to groups like unemployed graduates. Since the late 1970s it was assumed that the generation of jobs would reduce poverty, when the development objective of small enterprises promotion was the contribution to the GDP. By the early 1980s, when NGOs became more involved in microcredit projects the poverty focus became more specific and direct which added to the contradiction and ambiguity of this concept. Jobs in the sense of wage employment became synonymous with self-employment; i.e. a woman trading in vegetables on a road side was often not distinguished from a person working for a wage in an enterprise (Dichter 1999).

Using the change in the number of workers in the microenterprise as an indicator for growth is often favoured because it is most easily and accurately remembered by the microenterprise owners when compared to alternative indicators such as income, changes in sales or assets, and it does not need to be deflated (Mead and Liedholm 1998). It should be mentioned that there were some difficulties for many microenterprise owners to distinguish between full-time, part-time and casual employment because the same employee can successively qualify for each category in any given time period; therefore, in this study all of them are considered to be the same.

In this study by comparing the means, medians and modes of the sample employee number at the start of the enterprise and during the last year, given in table 6.6, there was no significant difference in the changes in employee numbers for this sector. On average, the microenterprises started with two workers and currently employ also an average of two workers, which is in line with a similar study by Baydas et al. (1997b).

Table 6.6: Change in employees numbers.

Employee	Formal Borrowers			Informal Borrowers			Total		
	Start-up	Before borrowing	After borrowing	Start-up	Before borrowing	After borrowing	Start -up	Before borrowing	After borrowing
Mean	2.3	2.4	2.4	2.2	2.5	2.6	2.3	2.5	2.5
Median	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Mode	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Sample	**50**	**50**	**50**	**45**	**45**	**45**	**95**	**95**	**95**

This finding reflects the nature of this sector where microenterprise employment is generally restricted to the owners and members of their families, as previously shown in table 5.6. The change in employee numbers during the life of the microenterprise is very limited as compared with results from other studies, as shown in table 6.7. Mead and Liedholm (1998) found in Botswana, Kenya, Malawi, and Swaziland that most microenterprises started with 1-4 workers and never expanded, and less than 1 percent grew into the category of over 10 employees. Also a study by Grosh and Somolekae (1996) in Botswana showed that only 2.5 percent of the enterprises grew above 10 employees; i.e. graduated to the small and medium enterprise sector.

Table 6.7: A comparison of employment growth rate in several countries.

Country	Average annual growth rate	Percentage that grew	Av. No of workers added per enterprise per year
Botswana	8.4	20.1	0.12
Kenya	29.0	34.8	0.26
Malawi	10.5	22.8	0.12
Swaziland	6.6	19.9	0.08
Zimbabwe	7.4	19.3	0.08
Dominican Republic	15.1	29.1	0.08
Egypt	**4.4**	**30.5**	**0.05**

Simple average growth rates are calculated as follows (current employment - initial employment)/initial employment/enterprise age. Adapted from Mead and Liedholm (1998).

Based on the change in the number of employees over the life of the business, only 22 percent of formal borrowers have positive growth compared to 40 percent of the informal borrowers. This finding refutes the hypothesis that formal finance leads to an increase in employee numbers. It should also be noted that almost 59 percent did not grow completely, and 10.5 percent have their employee numbers decreased, as shown in table 6.8.

Table 6.8: The growth in employment direction since the day of inception.

Employment Growth	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
No employment growth	33	66.0	23	51.1	56	58.9
Positive employment growth	11	22.0	18	40.0	29	30.5
Negative growth employment	6	12.0	4	8.9	10	10.5
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

The previous two tables address the question of whether the microenterprise sector is ever going to be in a position that can offer substantial employment; the answer is obviously no. Microenterprises in terms of employment growth can be said to be stagnant.

In order to investigate this matter further and to measure the direct impact of finance on employment generation, the respondents where asked to recall the change in their employees numbers during the last 12 months. They were informed that the aim of this question is to measure the impact of borrowing on their employee numbers; the result is given in table 6.9. The table shows that the majority of both groups have not experienced any change in employment in their businesses over the previous year, in general, or due to borrowing form informal or formal sources. Only very few, 4 percent, of the respondents mentioned that loans have an effect on employment. This result is in line with a similar study by Mead and Liedholm (1998), where almost one third of the microenterprises added workers after start up, around 60 percent remained the same, and 10 percent contracted in terms of employment.

Table 6.9: Change in employees numbers during the last 12 months.

	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
No change in employee	49	98.0	42	93.3	91	95.8
Change in employee number due to borrowing	1	2.0	3	6.7	4	4.2
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

By using a chi-square analysis to test for any statistical significant differences (Pearson chi square 4.093, df 2, and sig. 0.252) between the two groups, there were found no statistical significant differences between the formal borrowers and informal groups with regard to changes in employment number during the last year.

The fact that there was no significant difference between the two groups lends further support to rejecting the tested hypothesis that formal finance has a significant role in microenterprise employees increase.

In terms of employment generation, the study showed that microenterprise finance make a negligible or limited contribution, which is in line with similar studies by Daniels et al. (1995), Elleithy (1996), Grosh and Somolekae (1996), Hulme et al. (1996), Hulme and Mosley (1996b), Dichter (1997), and Mead and Liedholm (1998). These studies argue that microenterprises are the least efficient and least remunerative of small enterprises, and that many new and very small ones do not expand in terms of employment. They are primarily survival-type or income generating activities and thus are not particularly appropriate targets for finance programs. Furthermore, most enterprises which began on a micro scale remain that way indefinitely.

On the other hand, few studies found some positive impacts of finance in terms of employment increase, e.g. Daniels et al. (1995) in a similar study found that of those who receive credit, 21 percent expanded in terms of employment number, compared to only 16 percent who never received credit. Also a study in several developing countries found a positive small impact among a small proportion of the borrowers, but only in terms of increase in the pay of current workers (Sebstad and Chen 1996). In other studies the impact on employment was primarily due to the start up of new enterprises (Buckley 1996). A study from Bolivia showed that credit was used to take on paid labour only after the business has grown to a certain critical size in terms of sales or output; before that, increases in employment tend to have been confined to family labour (Mosley 1996). Also in a study by Mosley (1996) in Indonesia, he found a stronger tendency of employment increase in the period following the loan than in the non borrowers control group. These findings generally indicate that the most significant employment impacts are related to increase in current employees wages, or increased hours of work by owners or current workers, and that there is no strong supporting evidence for the positive impact of finance on employment generation.

As mentioned in the previous section, most studies in this sector found that the increase in employment was associated with improved economic efficiency or the better overall macro economic performance in the country. When the economy itself is growing well, microenterprise also flourishes, adding new employees to their work force and net income increases as well. On the other hand, when the economy is stagnant few enterprises are expanding in terms of employment (Elleithy 1996; Mead and Liedholm 1998).

6.3.3 Finance and fixed assets accumulation

The fourth hypothesis: Microenterprises which use formal finance increase their fixed assets accumulation significantly compared to microenterprises which do not use formal finance.

Microenterprises' access to formal finance increases growth potential through fixed assets accumulation. Some researchers argue that the accumulation of microenterprise fixed assets may be one of the most important long-term alleged impacts of microenterprise finance, especially among the low-income borrowers (Hulme and Mosley 1996; Sebstad and Chen 1996). They argue that this accumulation of microenterprise fixed assets can be used to expand or improve productivity within the microenterprise. This may enhance the income generating potential of the microenterprise in the current and future periods, and may improve the ability of the enterprise to deal with market risks. Furthermore, investments in physical capital assets allow microenterprises to provide collateral and in turn access debt financing more easily.

To test this hypothesis, respondents were asked about the microenterprises' fixed assets purchased during the past 12 months and the source of funding for these purchases; the results are shown in table 6.10. It was found that most respondents (62 percent) did not buy any fixed assets during the last 12 months period.

Table 6.10: During the last 12 months, did you purchase or invest in any of the following assets?

Types of Assets	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Purchased small tools	3	6.0	6	13.3	9	9.5
Purchased major tools	17	34.0	10	22.2	27	28.4
Invested in new building	0	0	0	0	0	0
Did not invest in fixed assets	**30**	**60.0**	**29**	**64.5**	**59**	**62.1**
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**
Fixed Assets Finance:						
Cash	1	5.0	3	18.8	4	11.1
NGO/bank loan	11	55.0	0	0	11	30.6
Instalments (Supplier credit)	8	40.0	12	75.0	20	55.6
Leased it	0	0	1	6.2	1	2.7
Total	**20**	**100.0**	**16**	**100.0**	**36**	**100.0**

When enquiring about how both groups managed to finance their fixed assets purchases, reported in table 6.10, the majority of both groups mentioned that they bought their fixed assets through instalment purchase (supplier credit). What was noted regarding fixed assets purchase is that for the formal borrowers the number of instalments purchases through supplier credit decreased in favour of formal loans. This finding could lend support to the notion that formal finance has a negative relation with the supplier credit. Furthermore, when comparing both groups' replies, it was noted that the supplier credit is available for fixed assets purchase and that the borrowers use formal loans to substitute the supplier credit, as they take out the loan and pay cash to benefit from the interest difference. The credit linkages between microenterprises and suppliers are weakening due to the formal finance. Table 6.10 reveals that about two-thirds of the purchased fixed assets by the informal borrower group were on instalments from merchants.

This study shows that among the major characteristics of this sector, as could be seen from table 6.11, is the need for working capital; 72 percent of this sector use finance for working capital. There was a common desire to get credit to purchase in bulk at a discounted unit price. Sometimes this strategy was combined with a desire to cut-out, or reduce dependence on middlemen in order to make more profit.

Table 6.11: Fixed assets and working capital needs.

	Formal borrowers		Informal borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Fixed assets loan	11	22.0	16	35.6	27	28.4
Working capital loan	39	78.0	29	64.4	68	71.6
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

By using a chi-square analysis to test for any statistical difference between the two groups, it was found that there was no significant difference (sig. 0.276) between the two groups with regard to the main purpose of the money borrowed. The average value of fixed assets, excluding land and building, as expected, varied significantly by sector. As was previously shown in figure 5.4, the trading activities have the highest value of fixed assets when compared to the manufacturing activities.

Tables 6.10 and 6.11 reveal that the microenterprise sector does not need high value fixed assets. This fact is reflected in the high return on capital employed calculated in table 5.21. The microenterprise sector needs credit mostly for working capital rather than fixed assets, and while the permanent capital base is small the working capital needs are both relatively large and fluctuating. Nevertheless, early borrowing needs are for the purchase of fixed capital to initiate the business, which is usually very low. After that, borrowed funds are more frequently used for the purchase of goods. As the microenterprise grows, its borrowing needs become relatively less oriented towards fixed assets and more oriented towards working capital, as argued earlier that the majority of this sector is not growth oriented but an income generating oriented sector.

Several studies that analysed fixed assets showed no growth or a marginal increase in fixed assets but a significant change in current assets, e.g. Buckley (1996) and Montgomery et al. (1996). Also, a survey in Sri Lanka by Hulme et al. (1996) found that formal finance is primarily used for working capital and only a very small percentage of the borrowers used it for fixed assets purchase.

On the other hand, several studies found a positive impact of credit on microenterprise assets, e.g. El-Mahdi and Osman (1999) and Sebstad and Chen (1996). These studies mainly examined the impact of credit on asset accumulation, without taking into consideration the availability of other sources to finance such purchases i.e. supplier credit. Also, what was noticed from these studies is that the general pattern of variation in asset change was not consistent, as they did not measure the alternative sources to such a formal finance where microenterprise can use to buy fixed assets i.e. supplier credit.

Here again, the evidence does not support the conventional wisdom that microenterprises' access to formal finance increases growth potential through fixed assets accumulation. Based on the test results and the fact that the bulk of perceived demand is typically for working capital rather than fixed assets, the tested hypothesis could not be supported. Nevertheless, the availability of formal finance increases the microenterprises' fixed assets purchase choices; hence, increasing their net income. What was also noticed is that the formal finance weakens major players in the market, notably the trade suppliers. This link between the supplier credit and the direct effects of formal finance is among the areas that needs further research within the Egyptian context.

It is worth mentioning that although supporting evidence that formal finance increases fixed assets accumulation could not be found, the microenterprises with larger values of physical assets use more formal loans. This is illustrated by figure 6.3 for formal borrowers, and the same trend for all respondents is illustrated by figure 6.4.

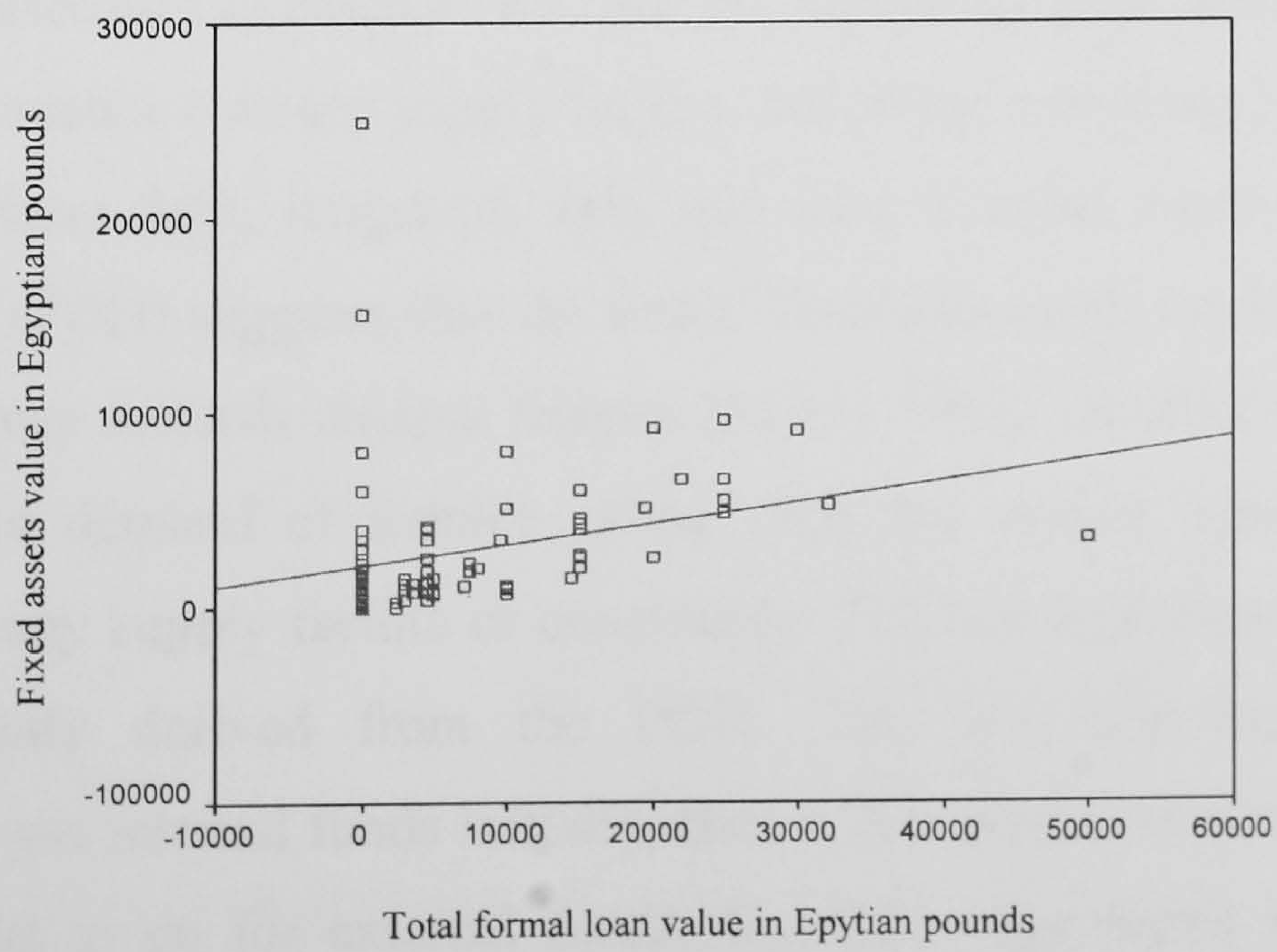

Figure 6.3: The relation between fixed assets value and formal loans (formal borrowers group).

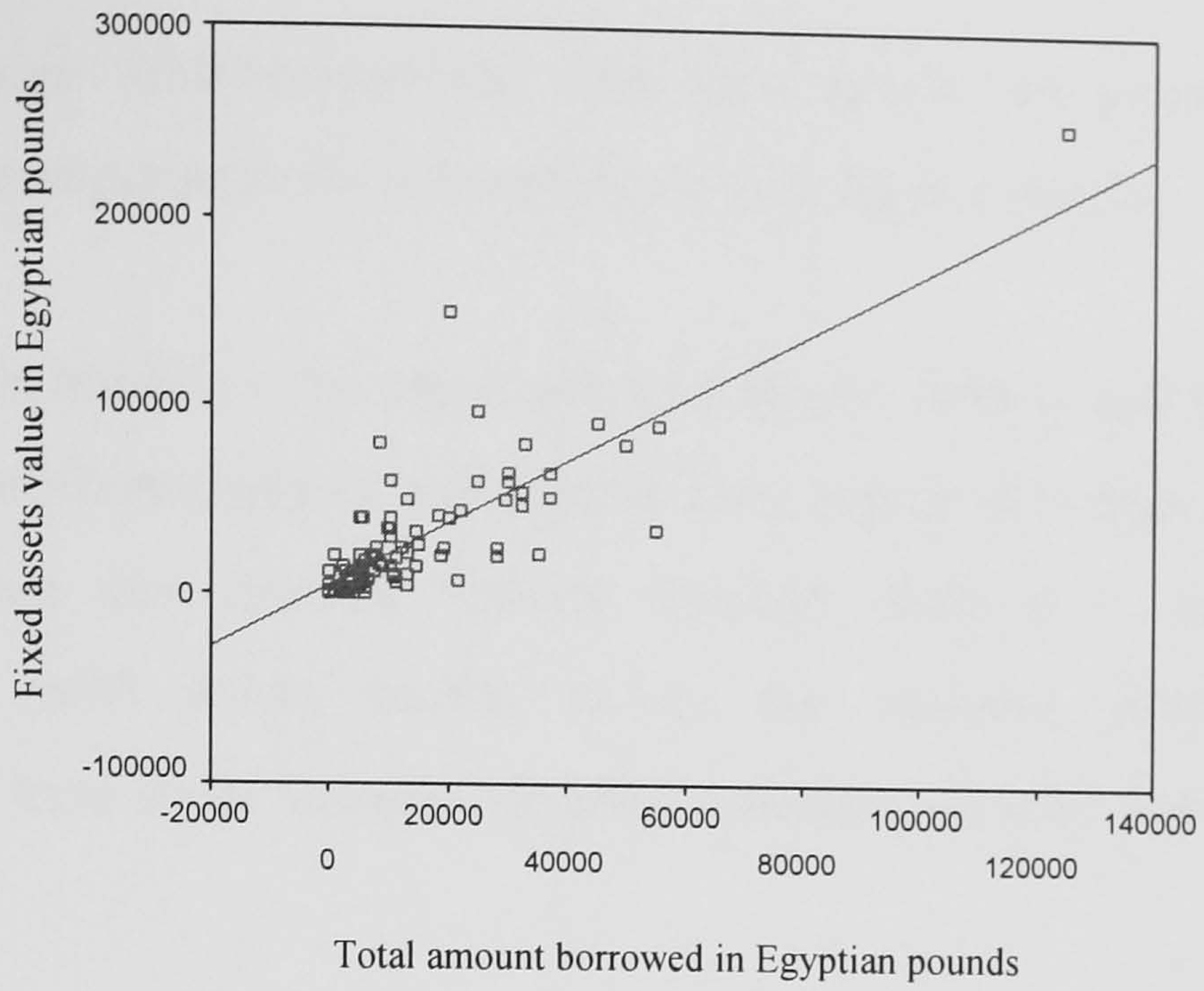

Figure 6.4: The relation between fixed assets value and formal loans (both groups).

This finding of a strong positive correlation between the fixed assets value and the loans value is in line with the asymmetric information theory, and in line with a similar study by Baydas et al. (1997b).

6.4 Demand for finance by microenterprises takes precedence over supply factors

The fifth and sixth hypotheses are derived from arguments by several researchers, as was previously discussed in chapter two, that the microenterprise demand factors for finance take precedence over the supply factors, following a pecking order of internal resources, short-term debt, long-term debt and then external equity. The pecking order hypothesis (POH) suggests that the firms' financing needs are hierarchical; i.e. there is a preference towards internal finance (Myers 1984). In other words, if a true pecking order for demand of finance exists, then this would dominate and take precedence over any supply factors or constraints. The two hypotheses tested in this section are mainly derived from the POH. The first hypothesis is that if microenterprises use internal funds initially, then it is expected that microenterprises with lower profits to go for external funds. The other hypothesis argues that the microenterprises owners' reluctance to widen finance is usually accompanied by being afraid of loosing control over the firm.

6.4.1 Microenterprise profit and finance type

The fifth hypothesis: Microenterprises with lower profits are expected to apply for external finance compared to microenterprises with higher profits.

This hypothesis is based on the assumption of Myers (1984) and Cook and Nixson (2000) that low profit enterprises will tend to have higher debt than high-profit firms. If microenterprises use internal finance initially, then it is expected that the microenterprises with lower profits to go for external funds. High profits microenterprises have more internal retained earnings, so they borrow less (Baydas et al. 1997b).

The relationship between net profit and total borrowings was investigated using spearman's rank order correlation to calculate the strength of the relationship between those two continuous variables. This is a non-parametric alternative to Pearson's product moment correlation. The result shows a positive relation with external borrowings, as shown in table 6.12. To prove the hypothesis, the expected relation should be negative, but table 6.12 shows a strong positive correlation between the two variables. The correlation between annual net profits and the loans amounts for the formal borrowers was 0.656, while for the informal borrowers it was slightly lower, 0.531.

Table 6.12: Spearman's rank order correlations.

Type of finance	Variables		Annual Net Income	Total loans
Formal borrowers	Annual Net Income	Correlation Coefficient	1.000	0.656
		Sig. (1-tailed)	0.0	0.000
		N	50	50
	Total loans	Correlation Coefficient	0.656	1.000
		Sig. (1-tailed)	0.000	0.0
		N	50	50
Informal borrowers	Annual Net Income	Correlation Coefficient	1.000	0.531
		Sig. (1-tailed)	0.0	0.000
		N	45	45
	Total loans	Correlation Coefficient	0.531	1.000
		Sig. (1-tailed)	0.000	0.0
		N	45	45

Furthermore, the value for the standard score form (Z) was calculated to indicate if there is any statistical difference between the two correlation coefficients of the two groups; it was -0.97. Since the value of Z is between the specified boundaries, -1.96 and 1.96, therefore, it can be concluded that there is no statistically significant difference in the strength of the correlation between the formal and informal borrowers groups. Therefore, the results could not support the above mentioned hypothesis and hence the assumption that the microenterprises with lower profits are expected to apply for external finance when compared to the microenterprises with higher profits could not be supported by this study.

This hypothesis was tested by several other researchers. These studies were mainly undertaken of the small and medium enterprises within developing countries, where proper records for such enterprises were maintained. Therefore it was difficult to find studies that cover this issue. Nevertheless, there was a similar study in Ghana of the small and medium enterprise sector by Aryeetey et al. (1994), which showed similar results. Aryeetey et al. (1994) study shows that enterprises with rising profits had applied for loans more than those with falling profits, which is in line with the findings of this study. Also in a study by Dunn (2002) found that microenterprises with higher levels of profits and assets tend to borrow more from both formal and informal sources.

6.4.2 Microenterprise control and finance type

The sixth hypothesis: Microenterprise owners who indicate a preference for retaining control are associated negatively with equity finance.

This hypothesis is based on the POH, where it suggests that among the primary reasons for the owners/managers of enterprises to use different sources of finance is their requirements for independence and control. Several researchers argue that the desire to retain control of MSEs is so strong that enterprises owners will protect it at any cost (Cosh and Hughes 1994; Read 1998; Howorth 1999). The POH assumes that a microenterprise usually follows a pecking order; therefore, it uses the safest sources first, internal resources, to the external equity as a last resort. MSEs owners therefore have a ranking by which they choose sources of finance. They start with their own personal savings, move on to debt finance when the need arises, and finally consider the least preferable option which is the equity of outsiders. Finance is sought in an order, which minimises external interference and ownership dilution by leaving equity as the last choice after retained earnings and short term debt are exhausted.

To test this hypothesis, both groups were asked to specify the acceptable percentage that could be owned by a partner; external equity participation. The majority of both groups, as shown in table 6.13, indicated that they do not need a partner, 72 and 58 percent respectively. Even among those who accepted a partner, they would not like the partner to have a controlling percentage, which is further illustrated by table 6.15.

Table 6.13: The acceptable percentage that could be owned by a partner.

	Formal Borrowers		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
Less than 25%	6	12.0	5	11.1	11	11.6
From 26% to 49%	7	14.0	12	26.7	19	20.0
From 50% to 75%	0	0	2	4.4	2	2.1
More than 75%	1	2.0	0	0	1	1.0
Do not mind having a partner	**14**	**28.0**	**19**	**42.2**	**33**	**34.7**
Do not need a partner	36	72.0	26	57.8	62	65.3
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

This interesting finding was further tested by using a chi-square analysis to test for any statistically significant differences between the two groups (chi-square value = 4.787, degree of freedom = 3, and Sig. level = 0.094). The significant level was found to be more than 0.05; therefore, there is no statistically significant difference between the formal and informal borrowers groups. Nevertheless, there is a stronger trend towards not using a partner to provide external equity by the formal borrowers group. To investigate this matter further, the respondents were asked to identify the main reasons for not wanting a partner, as shown in table 6.14. This table reveals that the majority of both groups give the main reason as retaining control of the business; formal borrowers have a higher trend towards retaining control, 92 percent compared to only 77 percent by the informal borrowers group.

Table 6.14: Reasons for not wanting a partner.

Reasons	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Want to keep control of the enterprise	33	91.7	20	76.9	53	85.5
Find difficulty in cooperating with others	3	8.4	6	23.1	9	14.5
Total	**36**	**100.0**	**26**	**100.0**	**62**	**100.0**

Although there was no statistical significant difference between the two groups (chi-square value = 2.879, degree of freedom = 1 and Sig. level = 0.090), the formal borrowers have a higher preference for retaining control. By taking the investigation one step further, the respondents who said that they do not mind having a partner were asked what kind of work the partner should be responsible of; as shown in table 6.15. This table reveals that almost 85 percent of both groups would prefer the partner to supply money only, and less than 10 percent do not mind involving the partner in running day to day operation; i.e. involvement in the administration of the microenterprise.

Table 6.15: The kind of work a partner should be responsible of (extent of involvement).

Kind of work	Formal Borrowers		Informal Borrowers		Total	
	Frequency	%	Frequency	%	Frequency	%
Administration (100 percent involvement)	2	14.3	1	5.3	3	9.0
Marketing (sales) only	0	0	2	10.5	2	6.1
Providing money only	12	85.7	16	84.2	28	84.9
Total	14	**100.0**	19	**100.0**	33	**100.0**

The overall preference of using equity finance in this sector, revealed from table 6.13, is very low or almost negligible. This is not surprising, given the fact that the majority of microenterprise owners work alone without partners, and where they do have partners, they are usually relatives or friends as discussed in detail in chapter five. Table 5.5 revealed that the majority of both groups were family partnerships, 56 percent and 31 percent respectively, which reflects the family nature of this sector. Non-family partnerships were 4 and 10 percent respectively. This relative openness towards accepting partners by informal borrowers may lend some support to Mayer's POH.

Although there was no strong statistical evidence, due to the nature and the relative small number in the sample, to significantly support the hypothesis, the strong preferences revealed in tables 6.13 and 6.14 is in favour of supporting the research hypothesis. Furthermore, this strong preference is supported by several other studies e.g. Islam et al. (1994), Baydas and Graham (1995), Baydas et al. (1997b) Buckley (1997), Read (1998) and Ozer and Yamak (2000), where they found that microenterprises owners do not welcome any source of finance that may lead to interference that would deny them their independence and control over their businesses, as they indicated a preference for debt rather than equity finance. The same results were also mentioned in Bolton's report; running your own business and working for yourself as psychological satisfactions appear to be much more powerful motivations than money or the possibility of large financial gains (Cosh and Hughes 1994). In a similar study by Smith (1997) in Scotland, over 50 percent of the respondents were unwilling to give up any share at all of their equity holdings in the microenterprises; furthermore, most enterprises wished to retain at least a controlling share of businesses; i.e. greater than 50 percent. As noted earlier, enterprises with higher levels of profits and assets often choose to borrow simultaneously from a number of both formal and informal sources (Liedholm 1992). Also in a study by Howorth (1999), the issue of ownership and control was central to the attitude towards introducing new equity. On average, 41 percent of the owners would consider a new equity investor if this did not affect their control of the business, but, if new equity meant some weakening or sharing of control, then only 22 percent of the owners would be interested. Nevertheless, Howorth (1999) found that the hierarchical preference structure of POH appears to be distorted according to the contextual factors and managerial preferences.

It is also worth mentioning that the assumptions that heavy reliance on internal sources of finance was the result, at least in part, of the fact that many microenterprises had been unable to raise external sources of finance is not proven by this study, as argued in chapter five.

Therefore, based on the above discussion it can be concluded that microenterprises owners' demand for finance takes precedence over supply factors, following a pecking order of internal resources, short term debt, to least preferred equity finance.

The financing preferences at the outset are constrained towards owners' equity, and then establish a preference for external debt over equity, as shown in table 6.16. It is suggested that the primary reason for this is the microenterprises owners' requirements for independence, which is consistent with the pecking order theory proposed by Myers (1984). The relevance of the pecking order theory raises serious questions about the cost effectiveness of allocating large amounts of resources to expensive microenterprise programs in developing countries (Baydas and Graham 1995). Therefore, the motivations of the microenterprises owners shape the financing practices.

6.5 Use of informal financial services

The seventh hypothesis: Microenterprises using the formal finance are less likely to use informal finance.

The working hypothesis here is that since formal short and long-term credit is most likely preferred to informal borrowing, firms that already have obtained formal borrowing will less likely turn to informal sources. Policy makers often assume that firms using informal finance are forced to do so because they lack access to formal financial services (Baydas et al. 1995). The most common line of reasoning is for informal finance being popular only by default. There is also a wide belief among development economists that the development process would result in increasing the availability of formal sources of borrowing, where informal sources would be displaced and eventually disappear (Cohen 2001; Dunn 2002). Furthermore, informal finance is sometimes wrongly regarded as a response to failure in acquiring formal finance.

Before testing this hypothesis it should be noted that the study sample was selected from an area that was well served by the financial services as mentioned in chapter four. Furthermore, the respondents themselves were obviously knowledgeable about banking as seen from chapter five where the majority are very well educated. As mentioned by Baydas et al. (1995), one way of separating the demand factors from the other factors which may affect the finance decisions is to study informal finance among individuals who have a ready access to formal financial institutions. Therefore to conclude that respondents used the informal finance because they lacked access to the supply of formal finance is not the case in the study.

Table 6.16 classifies the sources of finance used by the respondents into formal and informal finance; it should be noted that most respondents consider trade credit as informal finance as mentioned in chapter five. This table shows that both groups use more than one source of finance at the same time, as was also shown in table 5.18. Table 5.18 revealed that all of the respondents belonging to the formal borrowers group use more than one source of finance when compared to the respondents in the informal borrowers group, where 15 percent use only one source. From both tables, table 5.18 and table 6.16, it can be concluded that most of them had used more than one form of finance.

Table 6.16: Sources of financing working capital.

Source	Total		Formal borrowers		Informal Borrowers		Sig. X2
	N	%	n	%	n	%	
Informal finance:							
Retained earnings	85	89.5	43	86.0	42	93.3	None
Supplier/ trade credit	79	83.2	45	90.0	34	75.6	None
RoSCAs	18	19.4	10	20.0	8	18.6	None
Getting a partner	6	6.3	2	4.0	4	8.9	a
Relatives and friends with/ without interest	6	6.3	5	10.0	1	2.2	None
Customer advances	5	5.5	3	6.3	2	4.7	a
Money lender/Pawnbroker	3	3.2	1	2.0	2	4.5	a
Formal finance:							
NGOs	50	52.6	50	100.0	0	0	b
Commercial banks	5	5.3	3	6	2	4.4	a
Total sources used	**257**		**162**		**95**		
Number of respondents	**95**		**50**		**45**		

a: It was not possible to test the statistical significance of these differences, because in order to perform a chi-square analysis, the lowest expected frequency in any cell should be 5 or more.
b: There is a statistically significant difference between the two groups.

By using chi-square analysis, table 6.16 reveals that there are no statistically significant differences between the formal and informal borrowers groups with regard to the informal sources of working capital except for NGO loans as the formal group sample was selected from an NGO. Furthermore, table 6.16 reveals the frequency of use of the different finance sources, which is characterised by a ranking order starting with the most frequently utilised then moving to the least. First the retained earnings are the main source of finance, second are the supplier credits and third come the formal loans from NGOs. The proportions in which these forms of finance were used are consistent with the POH.

Despite all of the advantages of the informal finance, shown in table 5.32, the formal finance amount is around double the informal finance amount as shown in table 6.17. Table 6.17 reveals that the microenterprises borrow larger amounts from the formal financial sources, and at the same time borrow from the informal sources, which is in line with what similar studies reported, e.g. Dunn (1996) where he points to the significant role played by informal borrowing. Even though informal loans tend to be small in size, they often account for a large proportion of the total funds borrowed, 56 percent. Table 6.17 reveals that the microenterprises that have access to formal finance still use the informal finance, and despite the fact that the value of formal finance of both groups are almost the same, formal finance has a direct effect on reducing the reliance on the supplier credit as previously mentioned. Supplier, or trade credit, represents 51 percent of the total finance for the informal borrowers group, while for the formal borrowers group it is only 25 percent.

Table 6.17: Value of loans in L.E.

Type of finance	Formal Borrowers		Informal Borrowers		Total	
	Value	**%**	**Value**	**%**	**Value**	**%**
Formal finance:						
This NGO	401,500	45	0	0	401,500	30
Loans from other NGO	159,000	18	0	0	159,000	12
Bank Loans	30,000	3	0	0	30,000	2
Total formal finance	**590,500**	**66**	**0**	**0**	**590,500**	**44**
Informal finance:						
Supplier/ trade credit	220,950	25	240,000	51	460,950	34
RoSCAs	32,550	4	119,000	25	151,550	11
Relatives and friends without interest	20,000	2	61,000	13	81,000	6
Moneylenders	7,200	1	25,000	5	32,200	2
Customers advances	16,000	2	23,500	5	39,500	3
Total of informal finance	**296,700**	**34**	**468,500**	**100**	**756,200**	**56**
Total finance	**887,200**	**100**	**468,500**	**100**	**1,355,700**	**100**
Number of respondents	**50**		**45**		**95**	

The total amount of informal finance was found to be surprisingly high, 56 percent, given the number of banking facilities that operated in the area studied. This high percentage of informal finance, 56 percent, is usually expected to be dominant in remote regions without banks or among unsophisticated people (Fry 1995; Yaron et al. 1998).

To investigate this matter further, both groups were asked if they consider the amount of the informal finance available to them sufficient or not; the result is summarised in table 6.18. It was found that there is a huge contrast between the two groups. By using a chi-square analysis to test for any statistical significant differences between the two groups (Chi-Square = 16.661, df = 1, and assumptions sig. 2 sided = 0.000), table 6.18 reveals that there is statistical significant differences between the formal and informal borrowers groups with regard to their perceived adequacy of the informal finance.

Table 6.18: Is the amount of the informal finance sufficient?

	Formal Borrowers		**Informal Borrowers**		**Total**	
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**
No	46	92.0	25	55.6	71	74.7
Yes	4	8.0	20	44.4	24	25.3
Total	**50**	**100.0**	**45**	**100.0**	**95**	**100.0**

Despite the fact that the majority of both groups, 75 percent, mentioned that the informal sources are not sufficient, 25 percent find that they are sufficient and can mange their businesses with the informal finance only. In a study undertaken in rural Egypt by Mohieldin and Wright (2000), despite their controversial conclusion, their study revealed that about 70 percent of the respondents used informal finance, although many of these transactions were small compared to formal loans. They concluded that informal loans were used for consumption while formal loans were used for productive purposes, and that the informal credit market is only a very imperfect substitute for formal credit. This conclusion is not in line with the results of this study, as could be seen from the two RoSCAs case studies that were previously cited in chapter five, and from table 5.27, where the loans were used for both consumption and production purposes. Opposite to what most believe, the formal loans bearing interest rates were mainly used for productive purposes, while the informal loans were used for both.

It is worth mentioning that several studies revealed that informal finance is not an important alternative to other forms of finance and advocate the substituting of the informal finance with the formal finance e.g. Mohieldin and Wright (2000) and Isaksson (2002). The substituting of the informal finance with more formal finance is an unachievable target, as shown in table 5.32 most microenterprise owners regard increasing social influence and trust to be among the most perceived advantages for the informal sector. This was in line with a study undertaken by Baydas et al. (1997b) within a formal bank in Egypt, where informal borrowers among bank employees mentioned that the increase of social links were among their main reasons for participating in the informal finance. As long as the profit motivation is not the only motivation for human behaviour as discussed in further detail in chapter two, informal finance will continue to exist beside the formal finance, as mentioned by Baydas et al. (1995) and Von-Pischke (1997) the social benefit of joining the informal finance outweighs any purely economic rationale motive. This social tie as advocated by Adams and Fitchett (1992) and Bouman and Hospes (1994) should be protected by the government policies and not damaged by the cheap formal credit offered.

Therefore based on table 5.18 and table 6.16, formal borrowers use more than one form of finance besides their formal sources, i.e. microenterprises often choose to borrow simultaneously from a number of both formal and informal sources. They even resort to extensive cross financing of their loans, as found by several studies e.g. Sinha and Matin (1998). Furthermore, microenterprise tend not to operate with much forward planning as indicated from table 5.20, and when the need is to raise cash quickly the dominant preference is always the informal finance. Furthermore, and also in line with the previous hypothesis, the informal finance is particularly attractive as an external source of microenterprise finance because it tends to be exempted from the regular monitoring that accompanies formal finance, thus enabling a microenterprise to maintain a level of independence and freedom of control.

It could be seen from the above discussion that formal finance does not substitute the informal credit markets. This study revealed that a lot of cross financing among the formal borrowers take place; therefore, the tested hypothesis that microenterprises using the formal finance are less likely to use the informal finance is rejected. This finding is in line with several studies e.g. a study by Sinha and Matin (1998) in India which concluded that the increased access to formal finance has not substituted the informal credit markets and their study, also, revealed a lot of cross financing. Also, in a study by Levenson and Besley (1996) in Taiwan on the informal financial markets found that with informal finance, particularly RoSCAs, participation increases with higher income. It is therefore not correct to view this market as an enclave for the economically disadvantaged or rather as a rational response to the failings of the formal sector, where the empirical evidence indicates that there is only limited substitution between formal and informal sources of debt.

The finding of this study that microenterprises which have access to the formal finance are still using the informal finance may be interpreted in two different ways, the first, as previously mentioned, being motivated by the increase of the social links or ties. The second interpretation may be that formal finance in Egypt may not be providing the types of financial services that microenterprises demand and they therefore, create these services, e.g. 16 percent of the total respondents refuse to participate in the formal sector finance due to religious reasons (see table 5.29).

The notion that the informal finance sector is an underdeveloped and exploitative sector could not be substantiated by this study. This notion is mainly derived from the attempts of understanding the efforts to develop rural financial markets in low-income countries, where informal finance is often thought to be antidevelopment, exploitive, geared to consumption rather than investment behaviour, and incapable of expanding to provide an appropriate volume and range of financial services (Pischke et al. 1983). These condemnations are usually made by people who do not participate in these markets. Their positions are frequently based on incomplete information, bias against informal private activity or on abuses, such as by moneylenders (Bouman 1994). Also a few researchers sometimes wrongly regard the informal finance as a response to failure in the formal finance, e.g. Steel et al. (1997). This regard confuses the chronology; informal arrangements preceded formal ones by tens of centuries, and are clearly the economically rational and natural types of savings and credit institutions for most people in the developing world today. Informal finance is overwhelmingly voluntary and sustainable (Adams and Fitchett 1992; Bouman 1994; Bouman and Hospes 1994; Pischke 1997).

It is worth mentioning that this study revealed that most of the informal loans, 93 percent, were unsecured and provided free of interest charge, except in a few cases. This is typical for most of the informal loans, as it is socially and religiously unacceptable to charge interest on these types of loans or hold collateral. Personal relations allow lenders to make judgments about the creditworthiness of their borrowers and induce borrowers to fulfil the repayment promise. The stereo type that this market is dominated by money lenders in the study can not be established also. Money lenders are present on a very limited scale; only around 3 percent of the total finance sources available for the respondents, which is a negligible amount. Furthermore, the two case studies that have been discussed in chapter five reveal how well this sector is organised, especially by the first case study example. As for the second case study example, it reveals the adaptability of this sector compared to the formal sector. These two cases suggest that the scope of responses to the informal financial activities until modern times is wider than commonly assumed.

Therefore, the notion or the conventional wisdom that this informal finance sector is an exploitive or underdeveloped sector, as concluded by several researchers, appears not to be true. The suggestion that the informal finance sector is a symptom of underdevelopment due to the absence of banks, an underdeveloped financial sector, or the lack of education or knowledge of users needs to be reconsidered.

6.6 Summary and conclusions

The primary objective of this chapter was to answer the two research questions of the study and to test the research hypotheses derived from them. The first research question was: Is there a relation between the growth of microenterprises in urban Egypt and the different forms of finance, formal and informal? There have only been a limited number of studies to date that have examined whether the different forms of formal and informal finance actually improve the microenterprise business. However, many of the findings presented in this chapter challenge some of the existing theoretically and empirically based expectations surrounding microenterprise finance. In general both groups were closely matched on the five key structural factors. They exhibited more similarities than differences in financing their businesses.

The main purpose of the first hypothesis was to test or establish the importance of finance to the sample groups and to discover if the lack of the formal finance is the major constraint for microenterprises. The hypothesis that the lack of formal finance is the major constraint is not supported by this study. Nevertheless, the analysis revealed that there is a certain constraint on the supply of finance in terms of working and fixed capital, but it is not the major constraint for microenterprises operating in this sector. This is an interesting result, and certainly works against a widespread myth, almost universally accepted, that the lack of formal finance is the major constraint facing microenterprises. The lack of access to formal finance may be overstated as a constraint because many firms indicated that their financial problems would not be solved by borrowings.

Furthermore, the results reported in this chapter indicate that using formal finance will not help much this sector; both formal and informal borrowers have not experienced any significant difference in their growth with regard to the increase in income, the increase in employment, or fixed assets accumulation. Furthermore, contrary to the popular belief, financial reasons were not reported to be the major reason for the decrease in net income. Therefore, based on the results of the tests, which resulted in the rejection of the first four hypotheses, the answer to the first question would be that the study could not reveal any strong relation between the growth of microenterprises in urban Egypt and the different forms of finance, whether formal or informal finance, as both groups' responses to the different forms of finance were almost the same.

As for the second research question, two of the remaining three testable hypotheses were derived from the POH, which seems to provide to a certain extent some useful explanations for microenterprise finance. The fifth hypothesis is that microenterprises with lower profits are expected to go for external finance. This hypothesis could not be proven by the tests. This mixed interpretation or justification goes beyond just economic reasoning as the characteristics of the people and the attitudes towards formal finance shape their preferences. The other hypothesis, the sixth, argues that microenterprises owners' reluctance to widen finance is usually accompanied by being afraid of loosing control over the enterprise, which was confirmed by the tests. Based on accepting this hypothesis it can be concluded that the personal attitude towards control may have an effect in the financing decisions. Furthermore, findings from the descriptive analysis in chapter five seem to support the argument that microenterprises would construct their own arrangements to secure their supply of funds. In doing so, they appear to prefer ways that would be in conformity with their objective functions, e.g. keeping control of the business.

The seventh hypothesis which is that microenterprises using the formal finance are less likely to use the informal finance was rejected. The tests indicated that there is a lot of cross financing and the formal borrowers still borrow form the informal sector.

The rejection of the fifth and seventh hypotheses and the acceptance of the sixth hypothesis with the aid of the descriptive analysis in chapter five lend strong support to answering the second research question. The second research question's answer would be that it is difficult to stereo type finance preference for this sector, as the microenterprise owners' personal characteristics and personal motives do play a major role in shaping microenterprise demand for finance. The overall economic environments together with the preferences of microenterprises owners appear to influence the patterns of financing of the microenterprise sector. Therefore, this study strongly argues that the ways in which microenterprises are financed are not related purely to gaps in the supply of small finance but also to gaps in demand. Therefore, understanding microenterprise is not simply about economics, it has as much to do with understanding people, their motivations, and the environment in which they live. Microenterprises owners who borrow may have unobservable traits, such as more entrepreneurial ability, that may contribute to differences in an outcome variable even without access to formal finance.

The answers to the two main research questions have major implications and recommendations for researchers, policy makers and financial institutions. This will be discussed in the next chapter.

Chapter Seven: Conclusion and Recommendations

7.1 Introduction

This study has highlighted that there is currently a large interest in understanding MSEs' financing, but little is known about the relative importance of the different forms of finance, formal and informal. This study reveals many new and interesting findings in urban microenterprise financing. It reinforces previous findings of the financing patterns of MSEs across several countries, as discussed in chapter five and chapter six. It also adds to the debate over how much benefit, if any, does this urban microenterprise sector gain from the formal financial services. It also highlights the primary role played by the personal characteristics of microenterprises owners in the explanation of urban microenterprises financing.

The purpose of this concluding chapter is to summarise and discuss the findings of this study and the recommendations derived from these findings on the theoretical, political and institutional levels. Also, questions arising from this study are used to propose an agenda for future research.

7.2 Findings of the study

This section highlights and discusses the main findings that emerged from the study, especially in the previous two chapters. However, first it should be mentioned that due to the restrictions of the data and the limited size of the sample in this study, the findings have to be qualified and cannot be presented as being of general applicability. Furthermore, as noted earlier in chapter five, the results of similar studies in different countries can not be simply generalised, as the cultural, environmental, and macro economical conditions have direct effects on the microenterprise financing decisions. With these qualifications in mind, the findings of this study are divided into two main parts, finance related findings, and general findings; i.e. findings related to areas other than finance.

7.2.1 Finance findings

In this section the main finance findings concluded from the study are summarised.

- There are more similarities than differences between microenterprise formal borrowers and informal borrowers in financing their start up capital. Overall, this study indicates that the majority of microenterprises owners start their businesses with very modest amounts of capital, less than 1,000 Egyptian pounds, which they raise from a limited number of sources. As the enterprise grows older the number of sources available increases from one to two sources, at start-up of the business, to more than 3 sources. While several studies on MSEs found that the under capitalisation problem is experienced by many young enterprises, this study could not substantiate such claims. Furthermore this study revealed that the microenterprise sector does not need a large amount of start-up capital nor does it need high value fixed assets.
- With regard to the sources of working capital, the most frequently used sources of financing were retained earnings and trade credit. Indeed, there were no significant differences between formal and informal borrowers groups, but the number of sources used by the formal borrower group was significantly more than the informal borrowers group. Furthermore, this study shows an amazing diversity in financing sources across this sector, where the majority of the microenterprises have several other options available to them other than the formal sources.
- The notion that the lack of finance is the major constraint for microenterprises' development is not supported by this study. Although the analysis revealed that there is a certain constraint on the supply of finance in terms of working and fixed capital, but it is not the major constraint for microenterprises in this study. The

poor market conditions and the lack of proper public services, utilities, and health care turned to be more important factors in limiting microenterprise growth.

- Contrary to the popular belief, the study revealed that finance was not reported to be the major reason for net income decrease. Microenterprise owners perceive neither finding credit nor high credit costs as financial problems. The study findings suggest that the formal finance contributes to a sustained growth among only a small proportion of microenterprises; while the majority of the study sample have not shown any significant growth in terms of net income increase, employment increase, or fixed assets accumulation. The large majority grow only up to a point, then level out regardless of accessibility to finance sources.
- Total amount borrowed by the informal borrowers group is not affected by their total sales. In other wards, it was observed that the informal lending is not directly related to the total sales; the sales figure of the microenterprise is not among the determining factors that decide on granting, and value of, the loans in the informal finance sector. What was also noticed is that the informal borrowers tend to have a lower turnover than the formal borrowers. One possible reason for this is that the formal borrowers choose a high growth strategy by taking out more loans from any source to increase their turnover and gain more money. Microenterprises which adopt an aggressive sale strategy tend to borrow more from both sources, formal and informal sources, which may result in higher income but not higher profit percentage. On the other hand, there is also a trend towards a positive relation between the total sales and the total amount borrowed in the formal borrowers group. Where as for the informal borrowers group, the total amount borrowed is not affected by the total sales.
- Though the predictions of the POH are partially supported by the study findings, the hierarchical preference structure of POH appears to be distorted according to the contextual factors, mainly microenterprises owners' preferences, as mentioned by Howorth (1999). Microenterprises owners' characteristics, personal motives, and attitudes do play a role in this distortion. Therefore, this study supports the argument that microenterprises owners would construct their own arrangements to secure their supply of funds. In doing so they appear to prefer ways that would be in conformity with their own objectives. Furthermore, the assumption that the microenterprises with lower profits are expected to apply for external finance

when compared to the microenterprises with higher profits could not be supported by this study. Microenterprises' financial structure is not a major determinant of finance in this sector.

- The results from this study indicate that the borrowing behaviour of the microenterprises reflects their perception of the financial markets; whether to retain control, which was partly proven by this study or through other factors like religious principles. Such principles, to a certain extent, do have some impact on the demand for finance. The limited use of formal financing seems to be personal preference of the microenterprises owners. Therefore, not all microenterprises under use formal finance services for essentially the same reasons. Microenterprises owners often choose to select themselves out of the formal finance sector based on their interpretations of what debt means or represents. In this study both groups' perception about the main features of the formal financial services available was completely different, especially with regard to their views of the lower interest rates, and longer repayment periods. As mentioned by North (1995), the immense variation in mental models possessed lead to the different perceptions of the world and the way it works.
- Microenterprises owners draw upon a complex set of informal and formal finance sources. Formal finance does not substitute the informal credit markets. This study revealed that a lot of cross financing among the formal borrowers take place; therefore, the tested hypothesis that microenterprises using the formal finance are less likely to use the informal finance was rejected. It is worth mentioning that some important sources of financing are not considered as loans, such as customer's advances and supplier credit.
- This sector is categorised with a very short growth cycle and that microenterprises reach maturity very quickly. Despite the fact that this sector has very high profit percentages, income generated by this sector is not put back into business; i.e. used to increase the microenterprise capital. This was observed from the growth pattern of this sector. The majority of this sector grows significantly at the beginning of their operation, 3-4 years, and then level out from the 8^{th}-9^{th} year. It is even negative in some instances over the rest of the microenterprise's life. Furthermore, the majority of the microenterprises do not grow at all, as measured by indicators of employment.

- The overall health of the economy and the country's infrastructure and status has a stronger effect on the urban microenterprise sector growth and development than the availability of formal finance sources. The relationships between enterprise performance and the state of the economy was identified by several respondents as a key determinant of their own success, despite the fact that such a relation, as mentioned by Mead and Liedholm (1998), is easily missed in enterprise-level surveys. The over all state of the country's economy, macro-economy, has a great impact in determining the demand for finance by the microenterprise sector.

7.2.2 General findings

In this section other findings concluded from the study are summarised.

- The research in urban microenterprise financing can be characterised by the lack of a theoretical framework. There are a lot of empirically based studies, but very few studies try to put the results into a broader theoretical framework. The preceding review of literature has highlighted the immense difference in unit of analysis by these studies, which resulted in so mixed assumptions that can hardly be compared or provide a satisfactory explanation. Furthermore, the traditional economic theory fails to consider the role of microenterprises owners' use of alternative financial services, informal finance, and the personal characteristics of the microenterprise owners. This vast contrast in unit of analysis and cultural background between one country and another indicates how difficult it is in this field of research to compare this sector of business across countries, even though they are all developing countries.
- One of the major difficulties that researchers encounter in the field of microenterprise is the lack of general consensus on the terms used. There is no uniform definition for this sector. Microenterprise means so many different things to so many different people, with dissimilar size ranges in terms of capital, assets, sales, and employment, etc. Furthermore, definitions used by aid donors differ, and this further confuses the picture. The lack of a unified operational definition in the literature for the microenterprise sector in general, and in Egypt in particular, is a major constraint in developing a favourable policy environment. A wide variety of definitions are used, not just in Egypt, but worldwide. Currently, numerous definitions are being used by the various organisations operating in the MSE environment.

- There is no clear understanding of what constitutes the microenterprise sector. Most of the research in this area is mainly linked with the poor, which is not the case in this study. As mentioned by Dichter (1999), since the microenterprise term started to develop and change according to the donors' programs, the core of microenterprise finance started to lose its way.
- With regard to the type of activities, this sector is a highly heterogonous collection of enterprises ranging from units engaged in survival activities to highly sophisticated enterprises. The majority operating in this sector are informal, in this study sample 97 percent, and therefore, they lack the legal registration and financial reporting that the formal sector requires. Furthermore, the urban microenterprise sector participants differed in their backgrounds, aspirations, nature, and scope of work. There is, even, a substantial heterogeneity in the socio-economic background of the microenterprises owners.
- It was initially believed that most of those in this sector are there by default; i.e., in the absence of jobs in the public and private sectors they had nowhere else to go but to set up their own microenterprises to earn their livelihood, a survival strategy. Microenterprises frequently have been characterised as consisting of many unemployed workers who operate mostly in the informal sector, but this was not the case in this study sample. The average annual growth rate of the sampled microenterprises was higher for the microenterprises that stated that their main motives for starting the business is that the excepted income from the business is greater than from other jobs. Therefore, it can be concluded that growth of the microenterprises rely more on the motives, which is personal or internal factors, than any other external factor such as finance.
- The majority of both groups were sole proprietorship or family partnership. Sole proprietorship constituted the main type of firms. Of the formal borrowers group, 60 percent were in partnership whether within the family or from outside and only 40 percent of the respondents in the informal borrowers group were in a partnership of any type. The majority of formal borrowers were single compared to non formal borrowers, which may be interpreted as that they tend to establish themselves first before any form of engagement; hence they may use all of the available sources to reach such an aim. Also formal borrowers have a tendency towards running more than one business, which could be a reflection of the risk

diversification strategy of investment and the trend towards more entrepreneurial attitude. Also the overall monthly income of formal borrowers is higher.

- Based on the change in the number of employees over the life of the business, it can be concluded that formal financing have made a relatively limited contribution to alleviating the unemployment problem, where the majority of the study sample did not grow completely, and 10.5 percent have their employee numbers decreased.
- Based on the test results, and the fact that the bulk of the perceived demand is typically for working capital rather than fixed assets, the tested hypothesis could not support the assumption that the availability of formal finance increases the microenterprises' fixed assets purchase choices and hence increasing their net profit. On the contrary, what was noticed is that the formal finance weakens the major players in the market; i.e. reduces suppliers' credit profits. Nevertheless, the exploitation of highly profitable opportunities by MSEs could be accelerated if they had greater access to external financing
- Non financial reasons may lead to the growth of the microenterprise, which can be immeasurable or not clear, e.g. microenterprise owners' traits. This assumption may interpret the contradictory findings existing between different microenterprises and even different studies. Therefore, personal traits and motivations of the microenterprises owners shape their financing decision.

7.3 Recommendations of the study

The findings of this study have considerable theoretical, political and institutional impacts for different groups of people, e.g. researchers, policy makers and investors at different levels. This section presents some realistic recommendations that are derived from this study, as Bryce (1965, p.77) mentions:

> "Properly defined and realistically approached, the small-industry field is important and can contribute much to the whole process of industrialisation. If confused by sentimentalism and approached emotionally with little regard for the costs and benefits involved, small industry development can easily become a missionary movement which accomplishes little but which diverts scarce resources of development

funds and people away from other activities which, in most situations. could produce more industrial growth."

7.3.1 On the theoretical level

On the theoretical level the following recommendations are derived from the study.

- Future research work in the financing of microenterprise should consider working with and refining a theoretical framework in order to add to the knowledge about microenterprise. This is also advocated by several researches, e.g. Baydas and Graham (1995), Read (1998) and Cook and Nixson (2000). Furthermore, future studies must attempt to go beyond a mere descriptive research and to address issues of financial constraints more directly, and to clearly seek testing of hypotheses.
- A uniform definition of microenterprise should be adopted. There is a strong need for a uniform definition for encouraging the empirical studies to render the results comparable, namely to foster better understanding of the sector, provide a consistent method of identifying the sector and target groups within it, and to help with the coordination efforts among all groups serving this sector.
- Researchers in this field should spend more time in defining this sector and segmenting it into several sectors as adopted in this study. Such segmentation would give more meaningful interoperation and would lead to proper comparison of such studies.
- The research in the area of microenterprise finance should not be linked with the area of poverty alleviation without further empirical studies. Also, assumptions that have been developed and emerged from the research work in advanced industrialised countries should not be taken for granted without empirical studies.
- Distinctive distinction between effective and notional demand for credit should be made in any finance related studies, where due to difficulties often encountered in gathering data, the effective demand for credit is usually not made.
- The individual characteristics and attitudes of small businesses owners should be incorporated in all of the studies related to the financing of the microenterprise sector. Most financing models neglect the microenterprise owners' personal characteristics such as personality, background, education, and experience. All of

these characteristics impinge on the financial decisions made. Therefore, any finance model developed should take into account the non-economic elements.

- Researchers in the field of Islamic finance should reconsider the notion that Islamic financial institutions are reluctant to use *Mushārakah*, equity finance, mainly due to supply factors such as the high risk embedded in such an instrument, if the Pecking Order Hypothesis (POH) stands to be true.

7.3.2 On the policy level

Understanding the true need of microenterprise finance helps in the formulation of policies for the development, growth, and survival of microenterprises. The lack of understanding of the demand for microenterprise finance has been an obstacle to this sector's development. Therefore, this section offers some useful insights or recommendations for designing policies that could enhance the efficiency of the urban financial markets, and help in the development of the urban microenterprise sector without necessarily using a special credit program as an intervention instrument.

- There is a strong need for an agreed upon definition for this sector to be adopted by the different Egyptian government authorities. The official operational definition should be looked at as a coordinating tool.
- There is a tendency in some government circles to think of MSEs as a homogenous sector. Microenterprises are heterogeneous in their characteristics, aptitudes and needs. The government's one single type of assistance or intervention will not effectively help this entire sector. Therefore, categorising it into groups helps to improve the understanding of their characteristics. This sector should be properly defined and grouped into, at least, two segments; i.e. similar to the segmentation adopted by this study. The classification into at least two segments, survivalists' enterprises and microenterprises, is similar to the segmentation adopted by other governments, e.g. South Africa. These two different segments have different needs in terms of support. Those designing assistance programs need to understand these differences and to determine which target group corresponds most closely with their priorities, and then design their assistance programs accordingly. It will also help the policy makers to set up priority schedules within the range of the limited resources.

- Governments and donor agencies should stop imposing programs or copying successful credit programs in other countries without taking into consideration the microenterprises' perceptions about the true need for financing. Having projects imposed on people without addressing or knowing their real demands will lead to catastrophic failures similar to rural credit programs in the early 70s.
- As mentioned by Morduch (1998), policy makers still view the offering of credit as a fast relief for complex situations, and old and difficult problems; it is much easier to expand the supply of loans than it is to undertake other reforms. In reality, the desire of governments to promote MSEs is often based on social and political considerations rather than on economic grounds. In light of the Egyptian government's scarce resources, allocating large amounts of resources to expensive microenterprise programs will not assist much in the development of the microenterprise sector, and the government's scarce resources should be allocated to other projects with higher benefits; i.e. the scarce resources may be directed towards better infrastructures rather than financing microenterprises.
- Policies aiming at encouraging urban microenterprise need to recognise the wider macro-economic context in which the sector is operating. As this sector coexists with, and depends on, other sectors in the economy, the future of this sector will depend to a great extent on general economic policies and conditions, and whether they are conducive to development or not. Among the policy objectives should be improving the macroeconomic environment and developing an efficient legal and judicial system that allows contract enforcement.
- Informal finance would continue to be of great importance to the urban microenterprise sector, so the government should start to support this informal finance market, and not issue laws to oppress this market.
- Trade finance is among the most significant sources of finance in the urban microenterprise sector. Therefore, the formal intervention should support input suppliers, and wholesalers in these sub sectors, which may be the most efficient method to reach the urban microenterprise sector cost effectively.
- Microenterprise financing should be directed away from trading activities, where such activities help the microenterprise owners only and do not have a larger impact. Furthermore, the size and stage of the businesses assisted by these

programs are such that they rarely generate new jobs, thus limiting another potential for helping the poor.

- The public policy approach to financing programmes should be abandoned. The study concludes that only limited intervention is preferable. This can be achieved through the allocation of resources to specific areas of intervention. Moreover, more microenterprises imply reduced profits for those already in businesses, and potentially undermine the viability of this entire sector.
- It is important that policy makers recognise that there is no single factor or constraint that offers a key to unblocking the growth for the urban microenterprise sector. The challenge to policy makers is to ensure that the need of this microenterprise sector is met and not just the expansion of urban microenterprise financing programmes. Expansion of financing programs alone is unlikely to increase the access and participation rates.
- There is a strong need for adequate statistical information on this sector in order to formulate policies and achieve clarity of objectives towards the MSEs.

7.3.3 On the institutional level

This section provides recommendations that may be useful to both those who are attempting to expand formal financial services and to those who wish to reform the existing financial services to accommodate the microenterprise sector. It is worth mentioning that although MSEs are a niche market; this study has highlighted the extent to which this sector is a profitable and bankable sector.

- While operations of microenterprises have a very high return on capital employed, which may even seem astronomical by the banking standards as discussed in chapter five, banks are reluctant to lend to such sector. In Egypt, banks are often unable, or unwilling, to undertake any form of lending to the urban microenterprise sector. It should also be clear that the absence of written accounts is not necessarily a barrier to access to formal finance. A microenterprise's activities can be observed over time by the prospective lender; these can provide indicators for determining appropriate loan sizes once issues of character and confidence are resolved.

- The microenterprise sector is bankable, as the microenterprises owners pay almost 24 percent in interest and they still can make profit of more than 40 - 80 percent net profit. Commercial banks should look at this sector as a market opportunity and not as a subsidised programme.
- Furthermore, as mentioned by Cohen (2001), the institutionalisation of listening to clients appears to have disappeared from the view of many financial institutions. Financial institutions can significantly improve their effectiveness by being more responsive to the microenterprise's own perspective about the finance demand; i.e. through an upward flow of information and not a top down approach.
- Different types of microenterprises have different characteristics and require different financial services. Thus, it would be worthwhile to encourage the development of a range of institutions that use specialised methods to serve their particular market niches. For example, commercial banks should be encouraged to lend on bases other than the mortgage and passbook system. They could experiment with wholesale credit through input suppliers, marketing agents, and NGOs.
- Microenterprises are not anti banking but they may be anti debt. The majority of the microenterprises in this study held at least one account with one of the commercial banks. Over 70 percent of the respondents from both groups were found to have bank accounts, despite the fact that out of the 70 million Egyptians only 10 million have any type of bank accounts (Routers 2002). A great deal of attention should be paid to education and to counselling of the microenterprises owners on how to approach financial institutions.
- The most suitable financing format for this niche market is through commercial banks adopting the NGOs' development methodology. A commercial bank is in a position to avoid the weak points of the NGOs and can accept savings from microenterprises without any restriction. However, on the other hand, banks have to be friendlier and adopt more informal approaches in dealing with this sector. Commercial banks, through some slight modifications of their procedures, can be able to manage these new services in a profitable way. For example, NBD has become a major supplier of microfinance in Egypt and it found that selective credit policies limit the access of MSEs to formal credit so that it is not uncommon among these enterprises to resort to their own internal funds or the informal credit

market for finance. Financial institutions should design and adapt their processes and products according to what is acceptable in the minds of the microenterprises owners.

- The financial institutions need to review their microenterprise policies as they are failing to create an environment in which they are seen by microenterprises as a source of advice, support, and assistance. Financial institutions should better understand their clients and how their programs can serve them.

7.4 Areas for further research

Although this study has dismissed many of the myths surrounding the financing of urban microenterprises, it has raised more questions and areas for further research. Those areas for further research may be a direct reflection of, as mentioned in chapters two and three, the scarcity of research work on microenterprise financing in Egypt. The rest of this section discusses the future research areas needed as revealed by this study.

- The parameters of this research have necessarily been limited in scope; its empirical findings were related predominantly to the experience of urban microenterprises in only one area of Egypt's capital, Cairo. To substantiate and further extend the findings of this research, similar studies elsewhere in other areas of Egypt are needed. A detailed analysis of areas in the south or the north of Egypt, where they have significant different cultural and environmental factors, is needed. Through these studies a more general conclusion can be drawn and hence a more effective policy for the microenterprise sector in Egypt can be formulated. Furthermore, this work can be seen as a tentative study and can be used as hypotheses for other research in other developing countries with similar conditions.
- Despite the fact that this study attempts to segment the microenterprise sector into three main segments and focus on the upper end of this sector, there are many unanswered questions regarding the extent of poverty in the urban microenterprise sector. For example, are microenterprises owners and their employees poor? Is the poverty rate higher in the microenterprise sector than in the rest of the economy? Who are the poor within this sector? Therefore, a diagnosis of the incidence of

poverty in the urban microenterprise sector is essential to evaluate the role of the microenterprise programs in poverty reduction. Such research would help in answering the question of whether microfinance finance programs are more desirable than other development projects or not. This will also help to answer questions such as, are poor people willing to borrow, or do they have the capacity to borrow? In other words, can they mange profitable activities and increase their standards of living? Such questions are not answered by most of the previously discussed studies.

- Further research is required to provide more insight into the relationship between supplier credit and formal finance. This relation is always overlooked by researchers investigating the finance gap and microfinance programs. This study has shown that there is an obvious heavy reliance on the supplier credit, and, in some cases, microenterprises owners never search for cheaper sources, e.g. NGOs or formal loans. Furthermore, cheap credit by the government may distort this relation and affect negatively another segment of the market which is the supplier or the wholesaler sector, i.e. reducing the supplier profits; these effects need further investigations.
- This study was based on the experiences of those urban microenterprises that have successfully started businesses and are still trading. As mentioned by Mead and Liedholm (1998), this sector is in a constant state of flux during any given period, new enterprises are being created while others are closing. Therefore, further research to cover the microenterprises that had closed down, or ceased to exist, is needed. The impact of finance constraints on such microenterprises needs to be investigated.
- Another area that would be of research interest is a comparison study of gender, male vs. female, attitude towards the different forms of finance, formal and informal finance, within the Egyptian context. Such a study would be of significant interest as the Egyptian culture and most of the eastern cultures are stereotyped by male gender domination. In such cultures the financial matters are mainly controlled by men. A similar study was undertaken by Read (1998) about the difference between the male and female microenterprises domination with regard to access to finance in the UK. Such a study, if replicated within a male dominated culture, can reveal interesting findings.

7.5 Final thoughts

The findings of this study highlight the complexity of the urban microenterprise financing and the need to control for more than just five structural factors or confounding variables as discussed in details in chapter four. This study attempted to present a picture of the actual demand for microenterprise financing in urban Egypt from the microenterprises owners' perspectives, where this sector's financing decisions are directly affected by their personal characteristics. This study revealed that from the microenterprises owners' perspectives, the finance gap is the cause of the microenterprises owners' preferences and not a shortcoming of the finance supply. Furthermore, there is no relationship between the different forms of finance used by the microenterprise sector and the growth and development of this sector, whether in terms of income growth, employment growth, or even fixed assets accumulation. Financial decision-making and the growth of the microenterprise are the products of the microenterprises owners' characteristics, ambitions, motivations, aspirations and their mental models. The researcher could not find a conclusive role for the different forms of finance in the microenterprise development and growth, but it seems that other factors like entrepreneurial traits do play a significant role.

Therefore, the financial structure of the urban microenterprises reflects the wishes and strategies of their owners as much as constraints placed upon them by finance suppliers. Furthermore, this study shows that it is difficult to argue that large numbers of microenterprises have a pressing need for credit. Perhaps one of the reasons why so many credit-driven government projects fail is because they are based on assumptions about credit needs that are incorrect or do not exist. Microenterprises derive their funding from a number of sources, even multiple sources, and decisions regarding the type of finance are based on a complex array of social, behavioural, and financial factors. Understanding microenterprises is therefore not simply about economics, it has as much to do with understanding people, their motivations, and the environment in which they live.

To conclude, it is no longer acceptable to focus on one side of the financing spectrum which is mainly the supply side and the delivery methodology without taking into consideration the microenterprises owners' perceptions. While more work is required to take this and other research to the next stage of strategy development for prospective providers, this study has highlighted the weak foundations of many assumptions that development organisations and financial institutions make about the urban microenterprises financing. The study revealed that the creation of conditions that would support self-sufficiency appears to be more important than the availability of external debt as perceived by the respondents. The overall remark form this study is the fact that the personal preference and the aspirations of the microenterprises owners play a major role in the financing decision of this sector.

Appendix A: Questionnaire

Part One: Characteristics of the microenterprise owner

1) Gender:
   a) Male.
   b) Female.

2) Age: _________ years.

3) Marital status:
   a) Married.
   b) Single.
   c) Widowed.

4) How many do you support (household size); dependency ratio?
   a) Number of minors ______.
   b) Husband/wife & relatives ______.

5) How many of your sons/daughters are in school? _____.

6) What level of education have you achieved?
   a) Illiterate.
   b) Read & write.
   c) Primary & Preparatory.
   d) Secondary.
   e) Intermediary.
   f) Univ./higher institute.

7) How far is your work from your home? _________________ km.

8) What is the main reason for starting your own business?
   a) To become self employed and gain more independence.
   b) Because the expected income from self employment is greater than the income from a salaried position.
   c) To follow the family tradition.
   d) Because there were no other employment opportunities available to generate income.
   e) To improve the living conditions.

9) Do you mange or own other enterprises, and how many are they? _____.

10) Please indicate the most important factor you consider when you decide to undertake a new business.
  a) Familiarity with the business.
  b) It is the season the product or service is in demand.
  c) What others are doing.
  d) The business seemed profitable.
  e) The working capital required for the business.
  f) I can do it and still take care of my family and other responsibilities.

11) Religion:
  a) Muslim.
  b) Christian.

Part Two: Characteristics of the microenterprise

12) Type of activity: ______________________.

13) How old is the enterprise (the business age)? ___________________.

14) How much did you use to start-up this business in terms of the prices of the establishment year (starting capital)? ___________________.
  What is your current Capital? ___________________.

15) How did you finance the initial start-up costs of the business? (Multiple responses are possible)?
  a) Self financing/personal savings.
  b) Working abroad (e.g. in the gulf).
  c) Relatives, friends or inheritance.
  d) Partnership with relatives.
  e) Partnership from outside the family.
  f) NGOs.
  g) Commercial Banks.
  h) Money lender/Pawns shop.
  i) *Gam'iya* (RoSCAs).
  j) Trade/Supplier credit.
  k) Customer advances.
  l) Others (please specify) ______________________________.

16) Was the previous source(s) of finance sufficient?
  a) No, this was the only source available, and I do not know of other sources.
  b) No, I was refused by other lenders.
  c) Yes, there was no need for other sources.
  d) Do not know.

17) What is the ownership structure of your enterprise?
   a) Sole proprietor (primarily your own enterprise).
   b) Family partnership (primarily a household enterprise).
   c) Non-family partnership (business partnership with others not in your household).
   d) A Limited liability company.

18) What is the range of your monthly income after deducting tax (Net Income)?
   a) 500 or less.
   b) 501 – 600.
   c) 601 – 700.
   d) More than 700.

19) How much are your total fixed assets approximately? _______________.

20) In managing your enterprise activity, do you keep your enterprise money separate from the money you have for personal and household expenses?
   a) Yes.
   b) No.

21) Do you calculate your profit based on records of your costs and earnings?
   a) Yes.
   b) No.

22) Do you pay taxes based on your records?
   a) Yes.
   b) No.

23) Do you have a business licence?
   a) Yes.
   b) No.

24) What changes in employee number have occurred during the business life (other than yourself)?

Description	Beginning of activity	Before borrowing*	Current employee(s)
Total no. employed full time (non-family member)			
Total no. employed part-time (non-family member)			
Total no. employed full time (family member)			
Total no. employed part-time (family member)			

*During the last 12 months

25) What are the average hours of operation of your enterprise?

	At the beginning	**Before borrowing (if any)***	**After borrowing (if any)***
Hours/day			
Days/week			

Part Three: Financial performance of the microenterprise

26) Was your monthly/annual income from this business, during the last 12 months, sufficient enough to run your business and support your family?
   a) Yes (please go to question 28).
   b) No.

27) How do you bridge the gap? (Multiple responses possible).
   a) Personal savings.
   b) Borrowing form relatives (with interest-business loans).
   c) Borrowing form relatives (without interest).
   d) Borrowing from Moneylender/Pawn broker.
   e) Borrowing from the banks/MFI (formal sector).
   f) Gam'iya (RoSCAs).
   g) Having a salaried job.

28) What sources do you use for financing your ongoing operations? (Multiple responses possible).
   a) Retained earnings of the enterprise.
   b) Individual money lender.
   c) Trade/supplier credit.
   d) Getting a partner.
   e) Borrowing from the banks/MFI (formal) sector.
   f) Gam'iya (RoSCAs).
   g) Borrowing from relatives or friends with interest.
   h) Other (please specify) ________________.

29) What is an acceptable percentage that could be owned by a partner?
   a) Less than 25%.
   b) From 26% to 49%.
   c) From 50% to 75%.
   d) More than 75%.
   e) I do not need a partner from outside the family (please go to question 31).

30) What kind of work should the partner be responsible of?
   a) Administration (solving day to day operation).
   b) Marketing.
   c) Providing money only.
   d) Providing raw materials, machinery or equipment.
   e) Other (please specify) ________________.

31) Why do not you want a partner?
   a) Want to keep control of the enterprise (afraid of losing control).
   b) Find difficulty in cooperating with others.
   c) Do not want to reveal my business profits.
   d) Other reasons (please specify) ________________________________.

32) Over the last 12 months, compared to the previous period, the net income you have been able to earn has:
   a) Decreased.
   b) Increased (please go to question 34).
   c) Stayed the same (please go to question 35).
   d) Do not know (please go to question 35).

33) **(If net income decreased)** what is the main reason for your net income decrease?
   a) Due to illness.
   b) Bad market conditions.
   c) Unable to get inputs at good prices.
   d) Strong competition.
   e) Higher cost of finance.
   f) Inability to find bank loans.
   g) Liquidity problems and cash shortage.
   h) Other (please specify) ________________________________.

34) **(If net income increased)** what is the main reason for your net income increase?
   a) Expansion of the current business e.g. selling in new markets.
   b) Introducing new products.
   c) Was able to buy inputs at cheaper price - reduced cost with cheaper source of credit.
   d) Hired more workers.
   e) Good market conditions.
   i) Other (please specify) ________________________________.

35) What is your product cycle for this enterprise (how long does it take from the time you purchase inputs to the time you sell most of the product)?
   a) Weekly.
   b) Every 2 weeks.
   c) Monthly.
   d) Other (please specify) ______________________________.

36) For the same cycle:
   - How much is your average total sales (cash and credit)? ____________.
   - How much is your (estimated) total cost for your last product cycle? (For all enterprise expenses, including inputs, transportation, hired labour, taxes, rent, water, light, and so forth) ________________.

37) Rate the respondent's ability to estimate his/her profit, costs, and earnings:
   a) Great deal of difficulty.
   b) Some difficulty.
   c) No difficulty.

38) During the last 12 months, did you purchase or invest in any of the following assets for your enterprise activity?
 a) Purchased small tools.
 b) Purchased major tools such as stoves, equipment, vehicles, and machinery.
 c) Invested in a new building.
 d) No (please go to question 40).

39) How did you get these assets?
 a) Purchased them with cash.
 b) Purchased with NGO/ bank loan.
 c) Purchased on instalment bases.
 d) Leased them.

40) Please indicate the sector you borrow from and the purpose:

Formal Sector		**Informal Sector**	
Business		Business	
Home consumption		Home consumption	

41) How did you use the most recent loan (during the last 12 months), if it was for business?
 a) For working capital.
 b) For fixed assets purchase.
 c) To repay an old loan.
 d) Others (please specify) ____________________________.

42) Do you have a bank account (current, savings, etc)?
 a) Yes.
 b) No (please go to question 44).

43) What was the main reason for opening this bank account?
 a) My savings are safer in a bank.
 b) I get a return on my savings.
 c) The bank/formal institute (NGO) would only offer me a loan if I opened an account.
 d) To facilitate my business transactions.
 e) Other (please specify) ____________________________________.

44) What is the value of the current loans used in your business?

Finance source	Value in Egyptian Pounds
a) From CEOSS	
b) From other NGO	
c) From Bank	
d) Gam'iya	
e) Supplier credit	
f) Relatives and friends without interest	
g) Relatives and friends with interest (money lender)	
h) Customers' advances	
i) Other (please specify)	
Total	

45) What did you use as a means of collateral for borrowing?

	Formal loans	Informal loans
None		
Land and building		
Business equipment & machinery		
Personal collateral (another person to guarantee you - government employee)		
Business registration		
Signed post dated cheques or promissory notes		
Jewellery (gold)		
Others		

Part Four: Attitudes of microenterprise owners towards other financial matters

46) How do you feel about being in debt?
a) Never wanted to be in debt.
b) Do not like it, but sometimes it is necessary.
c) Do not mind as long as I can repay it or the terms are not too severe.
d) Do not know.

47) Have you ever had any difficulty in making a payment?
a) Yes.
b) No (please go to question 51).

48) What caused your repayment problems?
a) The business activity was not profitable.
b) I, or others in my family, have been sick.
c) Used some of the loan money for food or other items for the household.
d) Poor market demand.
e) Raw material problems.
f) Other (please specify) ______________________.

49) Please indicate, in rank order, your 3 most preferred features or advantages of the formal finance in your personal opinion.
   a) Lower interest rate than other informal sources of credit.
   b) Steady source of capital – availability.
   c) Larger of loan value.
   d) Collateral requirements.
   e) Offers other financial services, such as savings, and checking account.
   f) Longer loan terms.

50) Please indicate, in rank order, your 3 most preferred features or advantages of the informal finance, in your personal opinion.
   a) Lower interest rate than other formal sources of credit.
   b) Steady source of capital- availability.
   c) Increasing social influence and trust.
   d) Efficiency, compared to formal finance (no bureaucracy).
   e) Lower transaction costs for client (transportation expenses, other administration charges).
   f) Payment flexibility.
   g) Freedom to use credit.
   h) Agreeing to religious principles.
   i) No forced savings or insurance (no collateral).

51) To what extent do you consider each of the following items as a constraint for your business?

Constraints	**None at all**	**To a limited extent**	**To an average extent**	**To some extent**	**To a great extent**
Problems related to markets, e.g. weak demand					
Lack of basic public services/utilities					
Government regulations e.g. taxes, bureaucratic procedures, labour regulations etc.					
High cost of row materials					
Lack of access to technology					
Lack of access to finance or liquidity constraints					
Lack of saving facilities					

52) Is the amount of informal credit that you can obtain sufficient to significantly increase productivity?
   a) Yes.
   b) No.

53) What is your future strategy for the next three years?
   a) Maintain the same size.
   b) Enlarge the size of the enterprise.
   c) Reduce the size of the enterprise.
   d) Enter into new business.
   e) Open a deposit account.
   f) Ownership of land or building.

54) How do you, mainly, plan to finance this future investment?
   a) Personal savings/Retained earnings of the business.
   b) Having loans from Banks/NGOs.
   c) Individual money lenders.
   d) Having a partner.
   e) Gam'iya.
   f) Other (please specify) ________________________.

55) Without formal borrowing, would you have been able to run your business?
   a) Yes.
   b) No.

56) Please indicate the main reason for not having a formal loan now or in the past?
   a) No need for loans at that time.
   b) A religious objection to interest.
   c) The loan amount is too small.
   d) I do not want to be in debt.
   e) Insufficient collateral.
   f) High interest.
   g) Availability of other sources.
   h) Fear of inability for repayments.
   i) No banking experience, do not know how or where to borrow from.
   j) High administration and transaction cost.
   k) Others (please specify) ________________________.

References

Abd El-Mageed, R. A. (1998). *Small and Micro Enterprises Assistance Programs in Egypt: A Case Study of the National Development Bank's Small Enterprise Credit Program*. Masters Thesis, School of Business, Economics and Communication, Cairo, The American University in Cairo.

Adams, D. W. and D. A. Fitchett, eds. (1992). *Informal Finance in Low-Income Countries*. Boulder, Colorado, Westview Press.

Adams, D. W. and P. B. Ghate (1992). "Where to From Here in Informal Finance?" In D. W. Adams and D. A. Fitchett, eds., *Informal Finance in Low-Income countries*. Boulder, Colorado, Westview Press, pp. 349-359.

Adams, D. W. and D. H. Graham (1981). "A Critique of Traditional Agricultural Credit Projects and Policies." *Journal of Development Economics* (8), pp. 347-366.

Adams, D. W. and J. D. Von-Pischke (1992). "Micro-Enterprise Credit Programs: Déjà Vu." *World Development*, 20 (10), pp. 1463-1470.

Adams, D. A., D. H. Graham and J. D. v. Pischke (1984). *Undermining Rural Development with Cheap Credit*. Boulder, Colorado, Westview Press.

Al-Naggar, A. A., ed. (1981). *Towards New Strategy for Economic Development in Developing Countries*. Cairo, Egypt, International Federation for Islamic Banking.

Aropyor, J. (1994). *The Role of Informal Sector in Development: A Case of the Sudanese Micro-Enterprises in Cairo*. Masters Thesis, School of Business, Economics and Communications, Cairo, The American University in Cairo.

Aryeetey, E., A. Baah-Nuakoh, T. Duggleby, H. Hettige and W. F. Steel (1994). *Supply and Demand for Finance of Small Enterprises in Ghana*. World Bank discussion papers, No. 251. Africa Technical Department Series. The World Bank, Washington, D.C.

Assaad, R. and M. Rouchdy (1998). "Poverty and Poverty Alleviation Strategies in Egypt." Available from: http://www.fordfound.org/global/office/index.cfm?office=Cairo.

Bakhoum, I., H. Bhaskara, C. Chimbano, E. M. Gonzlez, W. Ognan, H. Ogola, A.-M. Quinones, J. Rahman and N. Sadeque. (1989). *Banking the Unbankable: Bringing Credit to the Poor.* London, Panos Publications Ltd.

Barasoum, G. and A. Shaban (1999). "Beyond Credit: An Impact Assessment of Microcredit Programs on the Livelihood of Poor Households in Egypt." In *Proceedings of Labour Market and Human Recourse Development in Egypt*. Cairo, Egypt, Economic Policy Initiative Consortium.

Bassal, M. A. H. (1998). "Industrial Development Bank experience." In *Proceedings of Small Enterprise Development in Egypt*, Cairo, Egypt.

Baydas, M. M., Z. Bahloul and D. Adams (1995). "Informal Finance in Egypt: 'Banks' within Banks." *World Development*, 23 (4), pp. 651-661.

Baydas, M. M. and D. H. Graham (1995). *Capital Structure Determinants Among Manufacturing Enterprises: The Case of Developing Financial Markets in Ghana and the Gambia.* Economics and Sociology Occasional Paper 2205. The Ohio State University, Columbos, Ohio.

Baydas, M. M., D. H. Graham and L. Valenzuela (1997a). *Commercial banks in Microfinance: New Actors in the Microfinance World.* USAID, Ohio.

Baydas, M. M., J. M. Porges, S. P. Wade and J. L. Walker (1997b). *Financial Reform for Small Business Development in Egypt.* Development Economic Policy Reform Analysis (DEPRA) Project, Cairo.

Belke, A. J. (1995). *The Promotion of Small and Micro Enterprises in Egypt: A Small Enterprise Development Project for the El- Kassabgy Community in Giza.* Masters Thesis, Cairo, The American University in Cairo.

Berger, A. N. and G. F. Udell (1998). "The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle." *Journal of Banking & Finance*, 22, pp. 613-673.

Bouman, F. J. A. (1994). "Informal Rural Finance: An Aladdin's Lamp of Information." In F. J. A. Bouman and O. Hospes, eds., *Financial Landscapes Reconstructed: the Fine Art of Mapping Development.* Oxford, Westview press.

Bouman, F. J. A. and O. Hospes, eds. (1994). *Financial Landscapes Reconstructed: The Fine Art of Mapping Development.* Oxford, Westview Press.

Brandsma, J. and R. Chaouali (1998). *Making Microfinance Work in The Middle East and North Africa.* World Bank, Middle East and North Africa Region, Washington, D.C.

Bryce, M. D. (1965). *Policies and Methods for Industrial Development.* New York, McGraw-Hill Book.

Buckley, G. (1996). "Financing The Jua Kali Sector in Kenya: The KERP Juhudi Scheme and Kenya Industrial Estates Informal Sector Programme." In D. Hulme and P. Mosley, eds., *Finance Against Poverty.* London, Routledge. Volume 2, pp. 271-332.

Buckley, G. (1997). "Microfinance in Africa: Is it Either the Problem or the Solution?" *World Development*, 25 (7), pp. 1081-1093.

Campbell, D. T. and J. C. Stanley (1963). *Experimental and Quasi-Experimental Designs for Research.* Chicago, Rand McNally.

Central Bank of Egypt (1999). *First Quarter Economic Review.* Central Bank of Egypt, Cairo.

CGAP (2002). "Consultative Group to Assist the Poor Phase III Strategy (2003-2008)." Available from: http://www.cgap.org/assets/CGAP%20IIII%20Strategy%20-%20Final%20October%204%202002.pdf.

Chaudhuri, S. and M. R. Gupta (1996). "Delayed Formal Credit, Bribing and the Informal Credit Market in Agriculture: A Theoretical Analysis." *Journal of Development Economics*, 51 (2), pp. 433-449.

Christen, R. P. and R. Rosenberg (2000). *The Rush to Regulate: Legal Frameworks for Microfinance.* CGAP Occasional Papers, Washington, D.C.

Churchill, C. F. (1999). *Client-Focused Lending: The Art of Individual Lending.* Toronto, Canada, Calmeadow.

CIA (2002). "The World Fact Book 2002." Available from: http://www.cia.gov/cia/publications/factbook/geos/eg.html.

Cohen, M. (2002). "Making microfinance more client-led." *Journal of International Development*, 14 (3), pp. 351-368.

Conover, W. J. (1980). *Practical Nonparametric Statistics* 2ed. New York, John Wiley & Sons.

Cook, P. and F. Nixson (2000). *Finance and Small and Medium-Sized Enterprise Development.* IDPM Working Papers Series (14). Report No. 1 902518659. Institute for Development Policy and Management, University of Manchester, Manchester: UK.

Cosh, A. and A. Hughes (1994). "Size, Financial Structure and Profitability: UK Companies in the 1980's." In A. Hughes and D. J. Storey, eds., *Finance and the Small Firm.* London, Routledge, pp. 18-63.

Crump, P. (1996). *Review of the Egyptian Micro-Credit Experience with Special Reference to UMI-Funded Credit Programs.* National Council for Negro Women, Cairo, Egypt.

Daniels, L., D. C. Mead and M. Musinga (1995). *Employment and Income in Micro and Small Enterprises in Kenya: Results of a 1995 Survey.* GEMINI Technical Report No. 92. GEMINI, Bethesda, MD.

Department of Trade and Industry (1995). "White Paper on National Strategy for The Development and Promotion of Small Business in South Africa." Available from: http://www.gov.za/whitepaper/1995/smallbus.htm.

Dhumale, R., A. Sapcanin and W. Tucker (1999). *Commercial Banking and Microfinance in Egypt: National Bank for Development.* Case Study Report. World bank, Washington.

Dichter, T. (1997). "Egypt - Alexandria Business Association (ABA)." *Case Studies in Microfinance, Sustainable Banking With the Poor.* Washington, D.C., The World Bank.

Dichter, T. (1999). "Non-Gvernmental Organizations (NGOs) In Microfinance: Past, Present and Future - An Essay." Available from: http://www.microfinancegateway.org/download/SBP/NGOs_Tom_Final.pdf.

Dunn, E. (1996). "Households, Microenterprises, and Debt." *AIMS paper.* Washington, D.C., Management Systems International.

Dunn, E. (2002). "Research Strategy For The Aims Core Impact Assessments." *AIMS Paper.* Washington, D.C., Management Systems International.

Elleithy, A. A. (1996). *New Small Manufacturing Firm Formation & Regional Development in Egypt.* Working Paper 9603. Economic Research Forum, Cairo.

El-Mahdi, A., N. Abdallah and O. Helmy (1999). "Provision of Finance to Small and Micro Enterprises: A Report on The Major Providers in Egypt." In *Proceedings of Labor Market and Human Recourse Development in Egypt*, Cairo, Egypt.

El-Mahdi, A. and M. Osman (1999). "An Assessment of the Effectiveness of Small and Micro-enterprise Finance Projects in Employment Creation." In *Proceedings of Labor Market and Human Recourse Development in Egypt*, Cairo, Egypt, Economic Policy Initiative Consortium.

El-Mahdi, A. (1995). "The Informal Sector in Egypt: A Brief Literature Review." In Proceedings of *The Dynamics of the Informal and Small-Scale Enterprise Sector*, Aswan, Egypt, Friedrich Ebert Stiftung.

El-Mahdi, A. E. and K. Powell (1999). *Small Entrepreneurs in Greater Cairo Community.* Survey on Socio Economic Conditions of Work in Greater Cairo. Social Research Center, The American University in Cairo, Cairo.

Evans, D. S. and B. Jovanovic (1989). "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints." *Journal of Political Economy*,. 97 (4), pp. 808-827.

Fischer, E. M., A. R. Reuber and L. S. Dyke (1993). "A theoretical Overview and Extension of Research on Sex, Gender, and Entrepreneurship." *Journal of Business Venturing*, 8 (2), pp. 151-168.

Floro, S. L. and P. A. Yotopoulos (1991). *Informal Credit Markets and the New Institutional Economics: The Case of Philippine Agriculture.* Boulder, Westview Press, Inc.

Fluck, Z., D. Holtz-Eakin and H. Rosen (1998). "Where Does The Money Come From? The Financing of Small Entrepreneurial Enterprises." *Metropolitan Studies Program Series Occasional Paper No. 191.* Syracuse, New York, Center for Policy Research Maxwell School of Citizenship and Public Affairs Syracuse University.

Fry, M. J. (1995). *Money, Interest, and Banking in Economic Development.* Baltimore, Johns Hopkins University Press.

Garson, J. (1997). *Microfinance and Anti-Poverty Strategies: A donor perspective.* New York, UNDP.

Ghate, P. B. (1994). "Lending to Micro Enterprises Through NGOs in the Philippines." In F. J. A. Bouman and O. Hospes, eds., *Financial landscapes reconstructed: the fine art of mapping development.* Oxford, Westview press.

Gonzalez-Vega, C. (1994). *Stages in The Evolution of Thought on Rural Finance A Vision from The Ohio State University.* Occasional Paper. Report No. 2134. Department of Agricultural Economics and Rural Sociology, Ohio.

Grosh, B. and G. Somolekae (1996). "Mighty Oaks from Little Acorns: Can Microenterprise Serve as the Seedbed of Industrialization?" *World Development*, 24 (12), pp. 1879-1890.

Gulli, H. (1998). *Microfinance and Poverty: Questioning the Conventional Wisdom.* Washington, D.C., Inter-American Development Bank.

Haidar, M. A. A. (1992). *The Financial Performance of Small Firms in Lebanon.* Ph.D., Durham University Business School, Durham, University of Durham.

Hamilton, R. T. and M. A. Fox (1998). "The Financing Preferences of Small Firm Owners." *International Journal of Entrepreneurial Behaviour and Research*, 4 (3), pp. 239-249.

Harper, M. (1998). *Profit For The Poor: Cases in Micro-finance*. London, Intermediate Technology Publications Ltd.

Hashemi, S. M., S. R. Schuler and A. P. Riley (1996). "Rural credit programs and women's empowerment in Bangladesh." *World Development*, 24 (4), pp. 635-654.

Heino, H. and J. A. Pagán (2001). "Assessing the Need For Microenterprises in Mexico to Borrow Start-up Capital." *Journal of Microfinance*, 3 (1), pp. 131-142.

Hoff, K., A. Braverman and J. E. Stiglitz, eds. (1993). *The Economics of Rural Organization: Theory, Practice, and Policy*. New York, Oxford University Press.

Holcombe, S. (1995). *Managing to empower: the Grameen Bank's experience of poverty alleviation*. London, Zed Press.

Hossain, M. (1988). *Credit for alleviation of rural poverty: the Grameen Bank in Bangladesh*. IFPRI, Washington, DC.

Howorth, C. (1999). "The Demand for Finance: Exploring The Pecking Order Hypothesis Within Small Firm Case Studies." In *Proceedings of International Conference on Funding Gaps Controversies*, University of Warwick.

Huband, M. (2001). "The Informal Sector." *Financial times survey: Annual Country Report*, p. IV.

Hulme, D. (2000). "Impact Assessment Methodologies for Microfinance: Theory, Experience and Better Practic." *World Development*, 28 (1), pp. 79-98.

Hulme, D., R. Montgomery and D. Bhattacharya (1996). "Mutual Finance and the Poor: A study of the Federation of Thrift and Credit Co-operatives (SANSA) in Sri Lanka." In D. Hulme and P. Mosley, eds., *Finance Against Poverty*. London, Routledge. Volume 2, pp. 177-245.

Hulme, D. and P. Mosley (1996a). *Finance Against Poverty*, Volume 1. London, Routledge.

Hulme, D. and P. Mosley (1996b). *Finance Against Poverty*, Volume 2. London, Routledge.

Hulme, D. and P. Mosley (1997). "Finance for the Poor or the Poorest? Financial Innovation, Poverty and Vulnerability." In G. D. Wood and I. A. Sharif, eds., *Who Needs Credit? Poverty and Finance in Bangladesh*. Dhaka, University Press Limited.

Inserra, A. (1996). *A Review of Approaches for Measurement of Microenterprise and Household Income.* AIMS Paper. Management Systems International, Washington, D. C.

Institute of National Planning (1998). *Egypt Human Development Report 1997/98.* UNDP, Cairo.

Isaksson, A. (2002). "The Importance of Informal Finance in Kenyan Manufacturing." Available from: http://www.unido.org/userfiles/PuffK/SIN_WPS05.pdf.

Islam, R., J. D. V. Pischke and J. M. d. Waard, eds. (1994). *Small Firms Informally Financed: Studies from Bangladesh.* Washington, D.C., The World Bank.

Jensen, M. C. and W. H. Meckling (1994). "The Nature of Man." *The Journal of Applied Corporate Finance*, 7 (2), pp. 4-19.

Johnson, S. and B. Rogaly (1997). *Microfinance and Poverty Reduction.* London, Oxfam.

Khandker, S. R. (1998). *Fighting Poverty with Microcredit: Experience in Bangladesh.* New York, Oxford University Press.

Lamberte, M. B. (1992). "Informal Finance in the Philippines' Footwear Industry." In D. W. Adams and D. A. Fitchett, eds., *Informal Finance in Low-Income countries.* Boulder, Colorado, Westview Press.

Lapar, M. L. A. (1991). *Growth and Dynamics of Small and Microenterprises: Does Finance Matter?* PIDS Working Paper Series No. 91-12. Philippine Institute for Development Studies, Makati, Philippine.

Levenson, A. R. and T. Besley (1996). "The Anatomy of an Informal Financial Market: Rosca Participation in Taiwan." *Journal of Development Economics*, 51 (1), pp. 45-68.

Levitsky, J. (1993). *Innovations in the Financing of Small and Microenterprises in Developing Countries.* International Labour Organization, Geneva , Switzerland.

Levy, B. (1993). "Obstacles to Developing Indigenous Small and Medium Enterprises: An Empirical Assessment." *The World Bank Economic Review*, 7 (1), pp. 65-84.

Liedholm, C. (1992). "Small-Scale Enterprise Dynamics and the Evolving Role of Informal Finance." In D. W. Adams and D. A. Fitchett, eds., *Informal Finance in Low-Income countries.* Boulder, Colorado, Westview Press, pp. 265-280.

Liedholm, C. and D. C. Mead (1999). *Small Enterprises and Economic Development: The Dynamics of Micro and Small Enterprises*. London, Routledge.

Machethe, C. L. (1997). *Determinants of Credit Constraints on Micro and Small Enterprises in the Northern Province of South Africa*. PhD, Department of Agriculture Economics, Michigan, Michigan State University.

Matin, I., D. Hulme and S. Rutherford (1999). *Financial Services for the Poor and Poorest: Deepening Understanding to Improve Provision*. Manchester, Institute for Development Policy and Management, University of Manchester.

McLeod, R. H. (1992). "The Financial Evolution of Small Businesses in Indonesia." In D. W. Adams and D. A. Fitchett, eds., *Informal Finance in Low-Income countries*. Boulder, Colorado, Westview Press, pp. 249-264.

McMahon, R. G. P., S. Holmes, P. J. Hutchinson and D. M. Forsaith (1993). *Small Enterprise Financial Management: Theory and Practice*. Australia, Harcourt Brace & Company.

Mead, D. C. and C. Liedholm (1998). "The Dynamics of Micro and Small Enterprises in Developing Countries." *World Development*, 26 (1), pp. 61-74.

Mead, D. C. and C. Morrisson (1996). "The Informal Sector Elephant." *World Development*, 24 (10), pp. 1611-1619.

Ministry of Economy (1998). *A Draft National Policy on Small and Medium Enterprises Development in Egypt*. Cairo, Egypt.

Mohieldin, M. S. and P. Wright (2000). "Formal and Informal Credit Markets in Egypt." *Economic Development and Cultural Change*, 48 (3), pp. 657-670.

Montgomery, R., D. Bhattacharya and D. Hulme (1996). "Credit for the Poor in Bangladesh: The BRAC Rural Development Programme and the Government Thana Resource Development Programme." In D. Hulme and P. Mosley, eds., *Finance Against Poverty*. London, Routledge. Volume 2, pp. 94-176.

Montiel, P. J., P.-R. Agenor and N. U. Haque (1993). *Informal Financial Markets in Developing Countries*. Oxford, Blackwell Publishers.

Morduch, J. (2000). "The Microfinance Schism." *World Development Journal*, 28 (4), pp. 617-629.

Morduch, J. (1998). *Does Microfinance Really Help the Poor? New Evidence From Flagship Programs in Bangladesh*. MacArthur Foundation.

Morduch, J. (1999). "The Microfinance Promise." *Journal of Economic Literature*, 37 (4), pp. 1569-1614.

Mosely, P. (1997). "The Use of Control Groups in Impact Assessments for Microfinance " Available from: http://www.ilo.org/public/english/employment/ent/papers/wpap19.htm.

Mosley, P. (1996). "India: The Regional Rural Banks." In D. Hulme and P. Mosley, eds., *Finance Against Poverty*. London, Routledge. Volume 2, pp. 246-270.

Mosley, P. (1996). "Indonesia: BKK, KURK and the BRI Unit Desa Institutions." In D. Hulme and P. Mosley, eds., *Finance Against Poverty*. London, Routledge. Volume 2, pp. 32-93.

Mosley, P. and D. Hulme (1998). "Microenterprise Finance: Is There a Conflict Between Growth and Poverty Alleviation?" *World Development*, 26 (5), pp. 783-790.

Myers, S. C. (1984). "The Capital Structure Puzzle." *The Journal of Finance*, 29 (3), pp. 575-592.

North, D. C. (1995). "The New Institutional Economics and Third World Development." In J. Harrisset al, eds., *The New Institutional Economics and Third World Development*. London, Routledge.

Norton, E. (1991). "Capital Structure and Small Growth Firms." *Journal of Small Business Finance*, 1 (2), pp. 161-177.

Osman, O. M. (1998). *Development and Poverty Reduction Strategies in Egypt*. Cairo, Economic Research Forum.

Otero, M. and E. Rhyne, eds. (1994). *The New World of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*. London, IT Publications.

Ozer, B. and S. Yamak (2000). "Self-sustaining Pattern of Finance in Small Businesses: Evidence from Turkey." *International Journal of Hospitality Management*, 19, pp. 261-273.

Padmanabhan, K. P. (1988). *Rural Credit: Lessons for Rural Bankers and Policy Makers*. London, Intermediate Technology Publications Ltd.

Parker, M. (1998). "Islamic Microfinance: Credit Where Credit Is Really Due." *Islamic Banker* (33), pp. 8-9.

Patrick, H. T. (1983). "Financial Development and Economic Growth in Developing Countries." In J. D. V. Pischke et al, eds., *Rural Financial Markets in Developing Countries*. Baltimore, Maryland, The Johns Hopkins University Press, pp. 50-57.

Pike, R. and B. Neale (1996). *Corporate Finance & Investment Decisions and Strategies*. London, Prentice Hall.

Pischke, J. D. V. (1997). "Poverty, Human Development and Financial Services." Available from: http://www.undp.org/hdro/papers/ocpapers/oc25.htm.

Pischke, J. D. V., D. W. Adams and G. Donald, eds. (1983). *Rural Financial Markets in Developing Countries*. Baltimore, Maryland, The Johns Hopkins University Press.

Rauch, J. E. (1991). "Modelling the Informal Sector Formally." *Journal of Development Economics,*, 35 (1), pp. 33-47.

Read, L. (1998). *The Financing of Small Business: A Comparative Study of Male and Female Business Owners*. London, Routledge.

Reid, G. C. (1996). *Capital Structure at Inception and the Short-Run Performance of Micro-Firms*. Discussion Paper Series. Report No. 9607. Center for Research into Industry, Enterprise, Finance and the Firm (CRIEFF), St. Andrews, Scotland.

Reid, G. C. and L. R. Jacobsen (1988). *The Small Entrepreneurial Firm*. Aberdeen, Aberdeen University Press.

Rhyne, E. and M. Otero (1994). "Financial Services for Microenterprises: Principles and Institutions." In M. Otero and E. Rhyne, eds., *The New World Of Microenterprise Finance: Building Healthy Financial Institutions for the Poor*. London, IT Publications, pp. 11-26.

Romano, C. A., G. A. Tanewski and K. X. Smyrnios (2000). "Capital Structure Decision Making: A Model For Family Business." *Journal of Business Venturing* (16), p. 285–310.

Routers (2002). "Banks Look Forward to the Retail Banking Sector in Egypt." *Al hayat*. London, pp. 12.

Sargent, M. and J. E. Young (1991). "The Entrepreneurial Search for Capital: a Behavioural Science Perspective." *Entrepreneurship & Regional Development*, 4 (3), pp. 237-252.

Sebstad, J. and G. Chen (1996). *Overview of Studies on the Impact of Microenterprise Credit*. AIMS Paper. Management Systems International, Washington, D. C.

Sebstad, J., C. Neill, C. Barnes and G. Chen (1995). "Assessing the Impacts of Microenterprise Interventions: A Framework for Analysis." *USAID Managing for Results*, Working Paper No. 7. USAID, Washington, D.C.

Seibel, H. D. (1996). *Microfinance strategies: Strategies for developing viable microfinance institutions and sustainable microfinancial services in Asia.* Working Paper No. 1996-2. University of Cologne, Cologne.

Seibel, H. D. (1997). *Upgrading, Downgrading, Linking, Innovating: Microfinance development strategies- A systems perspective.* Working Paper No. 1997-6. University of Cologne, Cologne.

Seibel, H. D. (1998a). *Local Monetization, Prudential Regulation and the Evolution of Microfinance Institutions.* Working paper No. 1998-1. University of Cologne, Cologne.

Seibel, H. D. (1998b). *Microfinance For the Poor Outreach vs. Institutional Viability Some observations.* Working Paper. Report No. 1 1998-9. Development Research Center, University of Cologne, Cologne.

Seibel, H. D. (1998c). "Microfinance Strategies: Strategies for Developing Viable Microfinance Institutions with Sustainable Services - The Asian Experience." In *Proceedings of Microcredit Conference*, Amman, Jordan.

Sethuraman, S. V. (1981). "The Role of the Urban informal Sector." In S. V. Sethuraman, ed., *The Urban Informal Sector in Developing Countries Employment, Poverty and Environment.* Geneva, Switzerland, International Labour Office, pp. 1-47.

Siam, I. (1996). *Development of Small Scale Enterprises The Role of Banks With Reference to the Egyptian Model: Importance - Obstacles - Future.* Unpublished work. National Bank for Development, Egypt.

Siegel, S., N. J. C. Jr. and N. J. Castellan (1988). *Nonparametric Statistics for the Behavioral Sciences.* London, McGraw-Hill.

Sinha, S. and I. Matin (1998). "Informal credit transactions of micro-credit borrowers in rural Bangladesh." *IDS Bulletin*, 29 (4), pp. 66-80.

Sisken, D. S. (1996). *Beyond Informality: The Importance of Macro & Local Level Environments in the Development of Small Firms in Egypt.* Working Papers Series. Report No. 9634. Economic Research Forum, Cairo.

Smith, J. A. (1997). *The Behaviour and Performance of Young Micro Firms: Evidence from New Businesses in Scotland.* Report No. 9711. Center for Research into Industry, Enterprise, Finance and the Firm (CRIEFF). St. Andrews, Scotland.

Social Fund for Development (1998). *Role of SFD in supporting & Developing Small Enterprises & How to Get a Loan for a Small Enterprise.* Cairo. Department of International Cooperation & Information, SFD.

Srivastava, P. (1998). "Interlinkage of Formal and Informal Credit Markets in India." In D. Khatkhate, ed., *Money and Finance: Issues, Institutions, Policies*. Mumbai, India, Orient Longman Ltd., pp. 217-232.

Steel, W. F., E. Aryeetey, H. Hettige and M. Nissanke (1997). "Informal Financial Markets Under Liberalization in Four African Countries." *World Development*, 25 (5), pp. 817-830.

Stiglitz, J. and A. Weiss (1981). "Credit rationing in markets with imperfect information." *American Economic Review*, 71 (3), pp. 393-410.

Stiglitz, J. E. (1999). "The World Bank at The Millennium." *The Economic Journal*, 109 (459), pp. 577-597.

Sutton, K. and W. Fahmi (2001). "Cairo's Urban Growth and Strategic Master Plans in the Light of Egypt's 1996 Population Census Results." *Cities*, 18 (3), pp. 135-149.

The Economist Intelligence Unit (2000). *Egypt Country Report 1st quarter 2000*. The Economist Intelligence Unit, London.

Tinker, I. (1995). "The Human Economy of Microentrepreneurs." In L. Dignard and J. Havet, eds., *Women in Micro- and Small- Scale Enterprise Development*. London, Westview press, pp. 22-39.

UNDP Special Unit for Microfinance (1999). *Building on Lessons Learned*. UNCDF Working Paper on Microfinance. The United Nations Capital Development Fund.

Von-Pischke, J. D. (1997). "Poverty, Human Development and Financial Services." Available from: http://www.undp.org/hdro/oc25.htm.

Wilson, R. (1999). *Banking and Finance in the Middle East 1999*. London, Financial Times Business.

Winborg, J. and H. Landstro (2001). "Financial Bootstrapping In Small Businesses: Examining Small Business Managers' Resource Acquisition Behaviors." *Journal of Business Venturing*, 16 (3), pp. 235-254.

Woller, G. M., C. Dunford and W. Woodworth (1999). " Where to Microfinance?" *International Journal of Economic Development*, 1 (1).

Yaron, J., M. Benjamin and S. Charitonenko (1998). "Promoting Efficient Rural Financial Intermediation." *The World Bank Research Observer*, 13 (2), pp. 147-70.

Zaman, H. (1999). *Assessing the poverty and Vulnerability Impact of Micro- Credit in Bangladesh: A Case Study of BRAC*. Washington, D.C., The World Bank.